COMPLIANCE WITH FEDERAL GASOLINE EXCISE TAX PROVISIONS

HEARING

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT

OF THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

NINETY-NINTH CONGRESS

SECOND SESSION

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COMPLIANCE WITH FEDERAL GASOLINE EXCISE TAX PROVISIONS

TUESDAY, JULY 15, 1986

House of Representatives,
Committee on Ways and Means,
Subcommittee on Oversight,
Washington, DC.

The subcommittee met, pursuant to call, at 9:10 a.m., in room 1100, Longworth House Office Building, Hon. J.J. Pickle (chairman of the subcommittee) presiding.

[The press release announcing the hearing follows:]

FOR IMMEDIATE RELEASE
WEDNESDAY, JULY 2, 1986

PRESS RELEASE #23
SUBCOMMITTEE ON OVERSIGHT
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES
1105 LONGWORTH HOUSE OFFICE BLDG.
WASHINGTON, D. C. 20515
TELEPHONE: (202) 225-5522

THE HONORABLE J. J. PICKLE (D., TEXAS), CHAIRMAN, SUBCOMMITTEE ON OVERSIGHT, COMMITTEE ON WAYS AND MEANS, U.S. HOUSE OF REPRESENTATIVES, ANNOUNCES A HEARING TO EXAMINE COMPLIANCE WITH THE FEDERAL GASOLINE EXCISE TAX LAWS AND RELATED FEDERAL ENFORCEMENT EFFORTS

The Honorable J. J. Pickle (D., Texas), Chairman, Subcommittee on Oversight, Committee on Ways and Means, U.S. House of Representatives, announced today that the Subcommittee will hold a hearing to examine compliance with the Federal gasoline excise tax provisions and related federal enforcement efforts. The hearing will be held on Tuesday, July 15, 1986, in the main Committee Hearing Room, 1100 Longworth House Office Building, beginning at 9:00 a.m.

Background

Under present law, a tax of nine cents per gallon is levied on the sale or use of gasoline by a producer or importer. (The sale of any gasoline mixture that is at least 10-percent alcohol (gasohol) is given a tax exemption of six cents per gallon.) The term "producer" includes an actual producer, as well as a refiner, compounder, blender, wholesale distributor, and a dealer selling gasoline exclusively to producers of gasoline. Any other person to whom gasoline is sold tax-free is considered to be a "producer", but only with respect to such gasoline. Generally, the tax is incurred and must be paid by a producer or importer who sells gasoline to a non-producer such as, for example, a retail gasoline station operator.

Gasoline may be sold tax-free by a producer or importer to another producer or importer if both the seller and the buyer are registered with the Internal Revenue Service (IRS). To register, the producer or importer must file Form 637, "Registration for Tax-Free Transactions", with the appropriate IRS District Director. A validated Form 637 serves as the certificate of registry. For a sale to be tax-free, the buyer must notify the seller in writing of the District Director with whom the buyer is registered and the certificate registry number.

Problem

Major criminal prosecutions and investigations have recently revealed that individuals and businesses, including organized crime figures, may be evading the Federal gasoline excise tax laws. This evasion is alleged to be accomplished through the combination of the use of bogus corporations, allegedly tax-free or tax-paid transactions, or by gaining access to registry numbers that are otherwise legitimate. Various Federal agencies, State taxing authorities and attorney general offices have expressed concern about such evasion schemes. Informal estimates of annual Federal revenue losses range from $100 million to over $1 billion. In addition, reports indicate that businesses that must compete with untaxed gasoline sales may have been adversely affected.

In a typical evasion scheme, an individual or a business may purchase gasoline tax-free using a "legitimate" registry number and, through a "daisy chain" series of tax-free paper transactions, the gasoline may be sold, sometimes at a discounted price, to a non-exempt producer or retailer. The seller then misrepresents that the Federal (as well as State and local) gasoline excise taxes already have been paid. Thus, the last producer in the chain receives a tax-included purchase price from the buyer, but the tax is never paid to the Federal government.

-MORE-

Witnesses invited to appear at the hearing include individuals having personal knowledge of gasoline excise tax evasion schemes, and representatives from the Department of Justice, the Federal Bureau of Investigation, the Federal Highway Administration, the Department of the Treasury, and the Internal Revenue Service. State tax administrators, as well as groups representing various segments of the gasoline industry, also have been invited to appear.

Details For Submission of Written Comments

Persons wishing to submit written comments for the printed record of the hearing should submit six (6) copies by the close of business, Monday, July 28, 1986, to Joseph K. Dowley, Chief Counsel, Committee on Ways and Means, U.S. House of Representatives, Room 1102 Longworth House Office Building, Washington, D. C. 20515.

SEE ENCLOSED FORMATTING REQUIREMENTS.

* * * *

Chairman PICKLE. The committee will come to order. We will ask our guests please to take their seats. If you do not have all the copies you want of statements, we ask that you get them during the morning. We would like for you to take your seats so we may proceed.

Today's hearing is an effort to ascertain the scope and significance of what many law enforcement and tax officials believe is an increasing problem—the evasion of Federal gasoline excise taxes.

America's roads and bridges are getting older. The cost of construction and repair is increasing at an astronomical rate. One response of both the Federal and State Governments has been to increase fuel excise taxes in order to pay for road development and reconstruction.

On the Federal level, the Surface Transportation Act of 1982 raised the Federal gasoline tax to 9 cents a gallon. Collected Federal gasoline excise taxes for fiscal year 1986 are estimated to be almost $9 billion a year. These excise tax receipts are placed in the Federal highway trust fund which are then used to meet Federal transportation priorities.

Clearly, any significant revenue loss from gasoline tax evasion has serious consequences for our country's transportation needs. Further, widespread evasion flaunts continued noncompliance with our Federal and State tax laws. Our committee is not willing to accept this.

Preliminary estimates provided to the subcommittee indicate that Federal gasoline excise tax evasion alone may total between $100 million and $1 billion annually.

It is the goal of this investigation to get answers to the following questions:

Do we have a serious Federal gasoline excise tax evasion problem? How many Federal dollars are lost each year?

Is this gasoline tax evasion a regional problem, or is it national in scope?

Are Federal efforts to end gasoline tax evasion adequate given the dimensions of the problem?

Are legislative and administrative changes needed?

In the view of many, Federal gasoline excise tax collection suffers from benign neglect. Recent reports indicate that criminal elements are profiting handsomely from this neglect using complex daisy chain schemes and extensive bootlegging operations.

Before we lend our support to any administrative and legislative changes, the questions I have asked, and others raised today at the hearing, must be answered to my satisfaction. Today will be the first effort, by the Congress, to make an analysis of the scope and nature of gasoline excise tax evasion.

Our witnesses today will help the subcommittee gain perspective on this problem. It is important, in making our review, that the subcommittee hear firsthand from those industry representatives having a direct stake in how gasoline excise taxes are collected and in compliance with the law.

Also, I look forward to hearing from Federal officials on their views of the problem and efforts underway to curb gasoline excise tax evasion.

I am concerned that the Federal Government has not been sufficiently alert or overly concerned about this huge ripoff. Contacts that were made by our committee to the Treasury and IRS have been routinely responded to. There is insufficient data collected to know how much our losses are or how widespread the problem is. If these facts are correct, it is time for action and prosecution of those involved.

We are holding this hearing today to find out what hasn't been done by the U.S. Government to deal with excise tax evasion.

The subcommittee welcomes the State officials appearing today. The issue is not only a Federal one. Most State and local governments have gasoline excise taxes as high or higher than the Federal excise tax. In most cases, these State and local taxes are evaded at the same time Federal tax laws are violated.

I look forward to their testimony.

Before we proceed, I am going to ask Mr. Schulze if he has an opening statement.

Mr. Schulze.

Mr. **Schulze**. Thank you, Mr. Chairman.

Recent network news stories and recent criminal prosecutions have strongly suggested that Federal gasoline excise tax evasion has increased significantly in the recent past. This is due in part, no doubt, to the high tax burden imposed on the sale of gasoline.

It is my understanding that the combination of State and Federal taxes, including local sales taxes, is as much as 27½ cents per gallon in some States. I believe it is appropriate for this subcommittee to carefully consider the current level of gasoline excise tax evasion, and to consider recommendations for improving compliance levels.

In considering the various recommendations we may hear today, we need to ensure that all parties involved with the production, distribution, and sale of gasoline are treated fairly, and that no one group is placed at a competitive disadvantage under the recommendations.

I look forward to hearing from the witnesses who will testify today and hope that we can reach a conclusion to solve this problem.

Thank you, Mr. Chairman.

Chairman **Pickle**. Thank you, Mr. Schulze.

Our first witness this morning is a convicted gasoline excise tax evader. We will refer to our witness as Mr. Witness. He is accompanied by two gentlemen, his attorneys. The Chair would ask you, would you want to identify yourselves or would you just identify yourself to the committee officially.

STATEMENT OF A CONVICTED GASOLINE EXCISE TAX EVADER, ACCOMPANIED BY LAWRENCE F. ROGERS, COUNSEL, NEW YORK, NY, AND JERRY D. BERNSTEIN, SPECIAL ATTORNEY, ORGANIZED CRIME STRIKE FORCE, U.S. DEPARTMENT OF JUSTICE

Mr. **Rogers**. I am Lawrence F. Rogers, 140 Cedar Street, New York, NY.

Mr. **Bernstein**. I am Jerry Bernstein, a special attorney with the U.S. Department of Justice located in Brooklyn, NY.

Chairman Pickle. Thank you.

We will hear from Mr. Witness now.

Do you have a prepared statement or will you talk from notes?

Mr. Witness. I would like to answer whatever questions you might have for me—I would be happy to answer any questions that you have.

Chairman Pickle. Do you have a statement?

Mr. Witness. No, sir; I don't have a statement.

Chairman Pickle. We have identified you as a convicted gasoline excise tax evader. Were you convicted in the year 1986?

Mr. Witness. Yes, I was.

Chairman Pickle. Will you tell us for what specific crimes have you been convicted?

Mr. Witness. I was convicted for—it was mail fraud surrounding the preparation of the excise tax.

Chairman Pickle. Is your only conviction for the evasion of excise tax?

Mr. Witness. Yes, sir.

Chairman Pickle. Federal?

Mr. Witness. Yes, sir.

Chairman Pickle. How large was your operation? Did you operate in one State or other States?

Mr. Witness. We operated in a number of States at one time.

Chairman Pickle. What is the number of States?

Mr. Witness. Four States at one time.

Chairman Pickle. Is it correct to say that your headquarters or your base from a State standpoint was New York?

Mr. Witness. Yes, sir.

Chairman Pickle. And the four States then probably are in that area?

Mr. Witness. The four States are Florida, New York, New Jersey, and Connecticut.

Chairman Pickle. New York, New Jersey, and Connecticut?

Mr. Witness. Yes, sir.

Chairman Pickle. Did you operate as an individual or with a group?

Mr. Witness. With a group, sir.

Chairman Pickle. Was it a company or was it an organization? Was it a business organization through which you profferred your services to the public?

Mr. Witness. It was a group of individuals, organized crime individuals that operated together to evade those taxes. It operated under various names, a daisy chain operation.

Chairman Pickle. Did the businesses, the people engaged there, have any connection with organized crime?

Mr. Witness. Yes, sir.

Chairman Pickle. We will ask in what detail later as we go along, on that manner.

If four individuals or four companies had been put together and you operated in four other States, your operation then would have been fairly extensive, if you were operating on that scale.

Could you give me some idea how much profit you made a week? When I say "profit," I am assuming that you collected taxes that were not paid to the Federal Government, so that would be a profit, I guess.

Mr. WITNESS. The four States involved, it would be about $8 million a week.

Chairman PICKLE. $8 million a week.

How did you happen to be caught? How were you apprehended in this scheme?

First, I think you ought to tell us how you operated so we would know the function of your so-called businesses and then you tell me how you were caught.

First, how did you operate? How was the scheme put together?

Mr. WITNESS. Primarily we operated because of the lack of enforcement or policing of the tax returns. That made it easy to operate.

Chairman PICKLE. There were no Federal agencies checking your operations as to whether you did or didn't pay and you just operated on a paper basis and nobody looked over your shoulder or investigated to see whether you were or were not paying?

Mr. WITNESS. Yes; that is correct.

Chairman PICKLE. So that made it easy for you to operate?

Mr. WITNESS. Yes, for the many years that I was in the business.

Chairman PICKLE. Now, tell me how you did it.

Mr. WITNESS. Well, basically we would have a company that was properly licensed, both State and federally, et cetera, in order to sell gasoline tax-free.

Chairman PICKLE. And you got that license from the State?

Mr. WITNESS. Yes, from the State and Federal Government.

Chairman PICKLE. Is it difficult to get the license?

Mr. WITNESS. No.

Chairman PICKLE. Just routine?

Mr. WITNESS. Routine, it took a few weeks and we would get multiple licenses for multiple names, then on paper show the gasoline sales to be tax-free from one company to the other and then eventually one of the companies would just disappear, like the final company that was charged with the collection of the taxes, that company would disappear; go on to a new company.

Chairman PICKLE. The company that has disappeared, is that the company which at that point had collected the excise tax from somebody?

Mr. WITNESS. Yes, sir.

Chairman PICKLE. They did make a sale at that point and they just evaded—just kept the taxes and eventually that dummy company would disappear?

Mr. WITNESS. That is correct.

Chairman PICKLE. Go out of business?

Mr. WITNESS. Yes.

Chairman PICKLE. Would the company be a local company or State company or international company?

Mr. WITNESS. Generally we used Panama companies, the Republic of Panama.

Chairman PICKLE. And that wasn't deemed to be unusual, a Panamanian company, everybody accepted that?

Mr. WITNESS. Yes; yes, they did.

Chairman PICKLE. All right.

Now, you made a profit of some $8 million a week. How long did that operation go on?

Mr. WITNESS. Several years; 2 or 3 years.

Chairman PICKLE. Were you ever audited by the Federal Government up until the very end?

Mr. WITNESS. No; no, I was not.

Chairman PICKLE. How were you caught or how were you apprehended?

Mr. WITNESS. Well, I was convicted on some tax charges in 1984 and as a result of that conviction, I became a fugitive and when I returned from being a fugitive, I cooperated with the U.S. attorney's office. That is how this investigation, my part in it came about.

Chairman PICKLE. I want to restate my question. I want to find out how did you get apprehended? You had a sweet deal. You were making $8 million a week, you and your company, and that went on for a year or 2 or 3, several years.

Mr. WITNESS. Yes.

Chairman PICKLE. How did you get caught? Who audited you? Who turned you in or why did the Government finally come after you?

Mr. WITNESS. I don't really know how they finally came after me.

Chairman PICKLE. Who did come after you?

Mr. WITNESS. The U.S. attorney's office, I was indicted for the evasion of State gasoline taxes of the State of New York and I was convicted after a trial.

Chairman PICKLE. So you do not know who turned you in or why they indicted you, but it was the State of New York, the district attorney in New York, or was it the U.S. attorney?

Mr. WITNESS. I guess it was the assistant attorney general for New York that first brought the charges, then it was converted to a Federal charge.

Chairman PICKLE. You could assume then if they indicted you somebody had evidence on you and they reported it to the district attorney's office and they looked into it and they thought it was sufficient to bring charges against you. Now it would seem then that the Federal Government at some point was mindful of this operation.

Do you think the Federal Government was aware of this for a period of 1, 2, 3 years?

Mr. WITNESS. Yes, I did report this to the authorities in 1979, that there was extensive tax fraud going on in the industry, and I went to the authorities about it. Really, I didn't get anywhere, there was no real action that I am aware of that took place as a result of my——

Chairman PICKLE. I notice that one of your attorneys, the gentleman on my left, was shaking his head. Do you think the Federal Government was aware that this was going on, but hadn't done anything about it? Why this specific case?

COUNSEL. One of the reasons they became aware of what was happening was because of Mr. Iorizzo's help, that is helping the news media in New York investigate the excise tax industry. I think when the true facts regarding this evasion came out, they were so shocking that everybody took notice for the first time and then investigations began of Mr. Iorizzo and others.

Chairman PICKLE. How much did the Federal Government lose each year in your estimation by virtue of these gasoline evasion tax schemes?

Mr. WITNESS. To answer your question correctly, I would like to suggest to the committee that you might consider not just gasoline tax, diesel fuel taxes, aviation fuel, was quite extensive also.

Chairman PICKLE. Aviation and what else?

Mr. WITNESS. And diesel fuel.

Chairman PICKLE. My question is, How much do you think that the Federal Government loses in taxes each year?

Mr. WITNESS. Just a guesstimate from my 20 years in the business, I would say around a billion dollars.

Chairman PICKLE. Annually?

Mr. WITNESS. Yes, sir.

Chairman PICKLE. How much will the States lose if the Federal Government would lose a billion dollars, in some cases the States have much more tax than does the Federal Government. Would the State lose about the same amount do you think?

Mr. WITNESS. Well, the States seem to police the taxes more stringently than the Federal Government does. In many cases, the operators will just evade the Federal Government taxes and pay the State. I would say it is probably twice as much as the Federal nationally anyway.

Chairman PICKLE. Well, I want to ask some of the other Members if they want to ask some questions at this point.

I guess my question to you is, Is this tax evasion of gasoline, diesel, and aviation fuel, national in scope?

Mr. WITNESS. From my experience, yes, it is.

Chairman PICKLE. So you operated in four different States, and if you operated in four States, you assume it is going on in other States. Is it going on in my State of Texas?

Mr. WITNESS. Yes, sir; it is.

Chairman PICKLE. Do you know that for a fact, of some of the people that would be involved?

Mr. WITNESS. Yes, I do; yes, sir.

Chairman PICKLE. Has that information been given to some authorities, any Federal authorities?

Mr. WITNESS. I am not sure. I think it has.

Chairman PICKLE. Do you two gentlemen with him know that, in my State and other States, whether you have cooperated with the Federal Government, and have given names and individuals involved, I assume?

Mr. WITNESS. Currently, I have been out of touch for close to 2 years, but at the time I was arrested, there was a specific operation going on in Texas that I did pass along to the Federal Government.

Chairman PICKLE. But the Federal authorities have that information?

Mr. WITNESS. Yes, sir.

Chairman PICKLE. Fine. Does any one State have a more difficult compliance problem than others? Are some States kind of an easy mark, some States tougher? How would you classify New York?

Mr. WITNESS. New York is very easy.

Chairman PICKLE. Pennsylvania?

Mr. WITNESS. No; Pennsylvania is a little more difficult.

Chairman PICKLE. New Jersey?

Mr. WITNESS. New Jersey is easy.

Chairman PICKLE. Arkansas?

Mr. WITNESS. I don't know anything about Arkansas.

Chairman PICKLE. I am going to conclude by asking you once more to tell me how your scheme works. You get a license from the State to sell fuel, different kinds, gasoline, aviation, or whatever kind, and you go to your State to get your license and they give it to you, and it is routinely issued, no questions asked.

Do you have to put up a bond?

Mr. WITNESS. In some States, but it is simple to do.

Chairman PICKLE. You just offer yourself as a businessman going into business, and you get a license and open up a business. Do you have a gasoline station somewhere?

Mr. WITNESS. No, we operate on the wholesale level.

Chairman PICKLE. So, you just have an office in some building?

Mr. WITNESS. Yes.

Chairman PICKLE. And you have stationery printed. Then you buy gasoline from a refiner.

Mr. WITNESS. Yes.

Chairman PICKLE. Do you actually buy it or do you buy it on paper?

Mr. WITNESS. We do buy it; yes.

Chairman PICKLE. So, initially, you have to have the money to buy the gasoline that you are going to consign to resell somebody.

Mr. WITNESS. Yes.

Chairman PICKLE. You get it tax-exempt, and when you get it on paper, you have a million gallons of gasoline to sell to somebody. Then you sell it to company A tax-exempt and company A sells it to company B tax-exempt and then to company C, and so on. At that point, C—or at some late stage, that dummy company says, we have already paid this gasoline tax. We have paid it.

Now, when that company says they have paid that gasoline tax, I assume then they offer that gasoline for sale to somebody at a reduced rate, at some kind of a discount, in some way, or otherwise the purchaser would just buy it from a regular wholesaler. Something would cause them to buy that gasoline from that dummy company, because they are going to get it at a discount, I assume, is that correct?

Mr. WITNESS. That is correct. The other advantage to the ultimate customer is in most cases, they can pay cash for the gasoline or diesel fuel or whatever, and there is no record of that transaction, and they then can evade the income taxes on the profit.

Chairman PICKLE. They pay cash and they pay less—in other words, given the 9 cents a gallon tax, the dummy company will add to it, but they will give you a discount of 5 cents a gallon, or whatever, and that is an inducement for that other company to buy it. Thus, they can sell gasoline then, say, 5 cents less than somebody down the street who pays the tax.

Mr. WITNESS. Right, and they can also evade the income tax on the profits from that gasoline.

Chairman **Pickle**. You were convicted because you were involved in this type of operation, and you actually were selling gasoline. What happened to company X? Were you the dummy company?

Mr. **Witness**. We just had phony offices up front, there was no real people.

Chairman **Pickle**. The people who made the claim that they had first collected the taxes, have they been prosecuted?

Mr. **Witness**. I am not familiar with the extent of the prosecutions at this point. I just don't know.

Chairman **Pickle**. We know who they are, at least. There is a name, maybe a phony name. You don't know whether that person was actually indicted, either?

Mr. **Witness**. Mr. Chairman, I am not quite sure I understand the question. I am sorry.

Chairman **Pickle**. I am saying, I guess I first ought to ask you, since you were convicted, are you the one who claimed that you paid the taxes?

Mr. **Witness**. No.

Chairman **Pickle**. You were just the originator and you sold it to dummy companies and down the line, somebody else claimed that they had paid the taxes and that person was not you?

Mr. **Witness**. No.

Chairman **Pickle**. I had understood you had actually been one of the dummy corporations and collected the taxes. Where did you get your money, then?

Mr. **Witness**. We collected the taxes, but the company ultimately responsible to pay the taxes to the authorities was just a phantom company, didn't have any real people, the company would just collapse.

Chairman **Pickle**. I don't know that I fully understand the exact operation, but in the interest of time, Mr. Schulze, do you have any questions to ask of Mr. Witness?

Mr. **Schulze**. Thank you, Mr. Chairman.

First, I would like to commend the witness for coming forth and helping us in this hearing. We appreciate very much your doing this. Would you just take a minute and tell us how you got involved?

Were you a legitimate businessman in the oil business, who saw this opportunity, or did you come to it from an organized crime position? Please explain to us how you learned of it, and how you became involved?

Mr. **Witness**. I was legitimately in the oil business for 20 years as a wholesaler, gasoline, aviation fuel, diesel fuel, stuff like that.

In the industry in general, it is just prevalent that taxes are just evaded constantly everywhere. It is a normal course of business every day.

Mr. **Schulze**. This was not necessarily an organized crime problem? Are there a lot of so-called legitimate businessmen out there who routinely do not pay these taxes?

Mr. **Witness**. That is correct. It is not an organized crime problem primarily.

Mr. **Schulze**. Please go ahead. I interrupted you.

Mr. **Witness**. In the process of my normal business, this opportunity presented itself, and it was very lucrative, and I just entered into it voluntarily along with everyone else in the industry.

Mr. **Schulze**. Did you enter gradually or did you make a conscious decision, "I am going to get a piece of this action?"

Mr. **Witness**. It was a conscious decision that was made in my particular case at one particular time.

Mr. **Schulze**. How about those with whom you did business who eventually bought the gasoline at a lower price? Were they really aware that they were involved with something that was slightly off-color, or were they totally innocent?

Mr. **Witness**. As I tried to explain, it is just prevalent in the industry. Everyone knows that everybody evades the taxes.

Mr. **Schulze**. It is common knowledge?

Mr. **Witness**. Yes.

Mr. **Schulze**. Are there any kickbacks or payoffs involved with this type of operation?

Mr. **Witness**. In what way?

Mr. **Schulze**. In any manner. I understand that there were political contributions during one of the investigations. Contributions were made to Governor Cuomo's campaign from some of these funds.

I wonder whether there are local politicians involved, State and Federal politicians involved with contributions, kickbacks, payoffs, any kind of——

Mr. **Witness**. The contributions that you mentioned were made, yes, but I just made them on directions of people above me, and I don't know what the reason for them were.

Mr. **Schulze**. You said you were a regular businessman that decided to get involved with gasoline excise tax evasion. When did the organized crime connection come along?

Mr. **Witness**. In our particular area of the country, it came in around 1980. I reported that to the authorities at the time, but——

Mr. **Schulze**. That is what you said earlier, about 1979, you went to the——

Mr. **Witness**. I went to the authorities, yes, about the infiltration of organized crime.

Mr. **Schulze**. Tell me about that.

Mr. **Witness**. There was an attempt to—well, some organized crime people wanted to purchase my company and visited with me and offered me a price. I wasn't interested in selling the company, and they took certain steps to try and force me to sell the company.

Mr. **Schulze**. Threats on your person?

Mr. **Witness**. Threats, things like that. I recorded those threats, and I brought the recordings and other things to the FBI and the IRS and complained about this infiltration attempt, and that is basically what happened.

Mr. **Schulze**. So in a way, you instigated the investigation, I presume?

Mr. **Witness**. Yes, I did.

Mr. **Schulze**. And as a result, you were convicted and sent to jail?

Mr. **Witness**. Yes.

Mr. SCHULZE. Will you describe for me what a daisy chain is? We have heard reference to it several times, but more specifically, tell us how it works.

Mr. WITNESS. A daisy chain basically is a legitimate company that has a good reputation in the industry, purchased gasoline tax-free based on its reputation and its own credit. There is no real funds necessary upfront because the company has good credit with the oil companies.

That company in turn sells gasoline tax-free to one or more companies that are fictitious, for want of a better description, fictitious companies with legitimate licenses.

This is done after the fact. The gasoline is sold first to the public. The taxes are collected, and then the paperwork is backed into a subsequent month. It was all done after the fact.

It was done even necessary to commit the crime. And in a subsequent month, the gasoline is charged off tax-free to a phantom company. That phantom company generates invoices showing all taxes paid to the customers, and then that company is gone, disappears.

Mr. SCHULZE. In your opinion, are the major oil refineries and companies aware of what is going on?

Mr. WITNESS. They are aware, but they just look the other way.

Mr. SCHULZE. My next question is whether they are involved with what is going on?

Mr. WITNESS. Major companies, not to my knowledge.

Mr. SCHULZE. But they do have some knowledge of it or, at least through the industry or through talk in the industry, they certainly must be aware of it?

Mr. WITNESS. Oh, yes, absolutely, no question.

Mr. SCHULZE. Do you have any evidence that they are concerned about the organized crime infiltration or the evasion of taxes?

Mr. WITNESS. Well, for instance, one major oil company in my operation knew about the infiltration of organized crime and knew that the tax was being evaded, yet to cover their tracks, they would constantly be complaining to the authorities about this problem, and in the meantime, they would be supplying our organization with gasoline.

Mr. SCHULZE. How about bootlegging versus tax evasion? In your opinion, is there as much——

Mr. WITNESS. Bootlegging—there are different types of bootlegging. Bootlegging that I am aware of through the years basically is products that are not gasoline chemically, but close, and that is sold as a motor fuel with extensive profits.

For instance, you could buy——

Mr. SCHULZE. In other words, petroleum-based chemicals or derivatives——

Mr. WITNESS. Toxic wastes. My first introduction to that was from—one second—was a gentleman by the name of Martin Carey, who was a brother to the former Governor of New York, and he was selling toxic waste through his service station chain in New York for some time.

And we were buying it for like 8 cents a gallon, selling it for $1.20.

Mr. SCHULZE. You would blend it in with other fuels?

Mr. Witness. Yes, blend it in with the gasoline and diesel fuels.

Chairman Pickle. Let's be sure we have this correct. Who was the company that was doing this?

Mr. Witness. The first one that I was associated with was Gas Value, which is Petroleum Combustion International, and it was owned by Carey's brother.

Chairman Pickle. That company was the one that did the blending and sold it to the public?

Mr. Schulze. Did they blend it or did they just sell the toxic waste?

Mr. Witness. No, they blended it in a terminal they had on Long Island, blended it with gasoline.

Chairman Pickle. Is that done by other dealers?

Mr. Witness. Yes.

Chairman Pickle. Is that common practice?

Mr. Witness. Yes.

Chairman Pickle. Does the Federal Government know that?

Mr. Witness. I reported it to them several times.

Chairman Pickle. You did report that to them?

Mr. Witness. Yes, sir.

Chairman Pickle. So what this company was doing was being done by other companies, too, and the authorities knew it, but nobody did anything about it?

Mr. Schulze. Mr. Chairman, I have used my time, and I appreciate the courtesy of the Chair. I have more questions, but I will wait until later.

Chairman Pickle. Mr. Guarini.

Mr. Guarini. Thank you for coming forward and giving us the benefit of your experience.

Counsel. With regard to the question regarding the payments to Mr. Cuomo's campaign fund, I have spoken to my client extensively about this, and he has absolutely no reason to believe that those campaign contributions were illegal in any way or done for any illegal purpose whatsoever.

I want to make that very, very clear.

Mr. Guarini. We accept that. Thank you.

Mr. Schulze. Were those contributions returned by Governor Cuomo or were they retained?

Mr. Witness. They were not returned, to my knowledge.

Chairman Pickle. If contributions were made to one candidate, I assume they were made to others. If they were given to Cuomo, they might have been given to Senator D'Amato or others. They were made without concessions or promises?

Mr. Witness. That is right.

Mr. Schulze. Were there other political contributions? Did you make others?

Mr. Witness. The answer is yes, there were others.

Mr. Schulze. Would you like to tell us who they were for? Were they all made just because you thought they were fine individuals, or were there other reasons for those campaign contributions?

Mr. Guarini. If the gentleman would yield, I think the importance would be if there was any political influence that was being exercised by reason of these kinds of contributions. That they were contributions made, that is one thing, but if they significantly influenced the candidates, that should be made clear.

Mr. SCHULZE. We are obviously treading on some tender ground here.

Mr. WITNESS. Excuse me a second.

Mr. GUARINI. Otherwise, I think what we are talking about is irrelevant and perhaps in another forum that could be taken up. We are going to go too far aground if we don't get back to the main subject matter, which is dealing with the bootlegging and the daisy chain operations that you are here to testify to.

May I proceed, Mr. Chairman?

Chairman PICKLE. Yes.

Mr. GUARINI. Is this problem of tax evasion in your estimation growing? Do you think it is more pervasive today and each year as it goes by, are we in an escalating situation?

Mr. WITNESS. I can only judge by what I see on the street. I look at the price at the service station, and if you take the wholesale price or the spot market price and add the proper taxes to that price, you come to a price that would be in excess of the street price.

The only conclusion you can draw from that is that it is still prevalent.

Mr. GUARINI. Do you have any recommendations as to how this can be avoided in the future in the manner that the taxes are charged and collected? From your experience, can you give us benefit as to how we can avoid the daisy chain or bootleg situation?

Mr. WITNESS. If there is a way for you gentlemen to legislate major oil companies, legitimate size oil companies would collect the taxes at that point.

Mr. GUARINI. Let's talk about major oil companies. Are major oil companies involved in this type of evasion of gasoline taxes in the same manner that the underworld is engaged in them?

Mr. WITNESS. To my knowledge, the major oil companies look the other way, but are not actively involved in the scheme, as far as evading the taxes.

Mr. GUARINI. There is no bootlegging operation in the major oil companies. Oil coming in from overseas is not monitored, getting into our consumption system?

Mr. WITNESS. That is taking place not really with the majors, but the intermediate suppliers, what they call the blenders. For instance, a cargo of Napa, which is a low-grade gasoline, can be brought in from overseas and there is really no authority looking for this product as a motor fuel, and it can be very easily blended up to a motor fuel and sold, and taxes collected with no border requirements.

Chairman PICKLE. Would the gentleman yield?

If I understood your answer about the collection of taxes and that legislation could be done, I assume you have reference to New York. New York did legislate, the tax being collected not at the first point of importation. Even though they have done that, are there ways to avoid these gasoline taxes?

Mr. WITNESS. Yes, because the neighboring States, Mr. Chairman, have not enacted the same legislation, so it is easy to move it back and forth between the States.

Mr. GUARINI. If the taxes were collected at the source of the production or the entry into the United States, as in the case of the tobacco industry, would that avoid the problem to a great extent?

Mr. WITNESS. I think it would greatly reduce the ability to evade the taxes. I am sure they would find other ways, but it would be a big dent in it, yes.

Mr. GUARINI. So, therefore, the method by which we collect the taxes should be reexamined, in your estimation?

Mr. WITNESS. From my experience, that is right.

Mr. GUARINI. Have you had much encounter with the IRS? Was it difficult to get a 637? Was there any investigation or was there no careful monitoring of the 637 exemption forms?

Mr. WITNESS. No, it is very simple. You mail off a form, and 2 weeks later, you get the license.

Mr. GUARINI. So, the IRS was not really monitoring the 637 exemption very carefully at all?

Mr. WITNESS. No, plus when the IRS ordered a tax return, there is no requirement on there about number of gallons or anything. It is just an amount of tax you put down.

Mr. GUARINI. What percentage of this tax evasion is going on as far as the underworld is concerned, as opposed to the legitimate people who are perpetrating the fraud?

Mr. WITNESS. Well, the underworld in the particular area of the country that I was familiar with controlled a lot of the retail outlets, so it was necessary for them to be involved in order to have the customers.

They control the real estate. That is why it was important. Nationwide evasion is just legitimate businessmen. I would not say it is organized crime nationwide.

Mr. GUARINI. So, the largest part of the violation is the daisy chain operation you are talking about, or is it the bootlegging part?

Mr. WITNESS. The daisy chain.

Mr. GUARINI. You say the major companies are looking the other way. The major oil companies know what is going on, but don't do anything about it, is that your testimony?

Mr. WITNESS. Absolutely, yes.

Mr. GUARINI. Can you give me an example as to how that would work, how they would turn their head the other way?

Mr. WITNESS. For instance, a major oil company—I won't mention a major oil company, a major oil company would be selling *x* amount of gallons a month. Suddenly, their sales would drop drastically through their service station outlets, but they would continue to supply our operation wholesale, like in the barge quantities, so that their income doesn't change.

They still sell the same amount of product, except a lot of it is sold through daisy chains. So, their income doesn't change, the loser is the State and Federal Government.

Mr. GUARINI. Wouldn't they have to make improper bookkeeping entries?

Mr. WITNESS. No. They just show a sale to one of our companies as a tax-free transaction, but they are aware of the fact that their own service station outlet's volume has dropped drastically.

Mr. GUARINI. You said, in New York and New Jersey that many of the stations are owned by the underworld, or the real estate of those stations is owned by the underworld. To what extent do you think the underworld has gotten into the gasoline business at the retail level?

Mr. WITNESS. I can only state in the tristate area of New York, a very substantial control of the retail outlets is by organized crime.

Mr. GUARINI. Thank you, Mr. Chairman.

Chairman PICKLE. Mr. Anthony.

Mr. ANTHONY. Thank you, Mr. Chairman.

Mr. Witness, I understand that you were in legitimate business for 20 years. During those 20 years, did you evade taxes, or did you pay your taxes?

Mr. WITNESS. We paid our taxes during that time.

Mr. ANTHONY. What was your personal motive to begin, after 20 years, to evade the payment of the gasoline excise taxes?

Mr. WITNESS. The evading was so big, so to speak, that my own service stations weren't buying any product at all from my company. Our economics were designed that we would earn our profits off of rental income and sale of gasoline. So, I controlled several hundred service stations, and they were only buying maybe 5 percent of their product from my company.

Mr. ANTHONY. What was your company?

Mr. WITNESS. The name of the company was Vantage Petroleum.

Mr. ANTHONY. Was it a wholesale distributor?

Mr. WITNESS. A wholesale distributor, operates several hundred service stations to independent dealers who had supply contracts to purchase their gasoline from the parent company, Vantage Petroleum.

Mr. ANTHONY. Over that 20-year period, you saw the sales to those individual retail stations go down?

Mr. WITNESS. Yes, it was down to almost 5 percent.

Mr. ANTHONY. Did you inquire as to why they were not purchasing gasoline from you?

Mr. WITNESS. Yes, there was no question. They told us they were buying from bootleggers, and that is when I went to the FBI and the IRS.

Mr. ANTHONY. This was prior to your beginning to involve yourself in illegal tax evasion?

Mr. WITNESS. Yes, sir.

Mr. ANTHONY. What was the response that you received from the Federal authorities?

Mr. WITNESS. They told me they would look into the matter, and about a year and a half later, I was indicted.

Mr. ANTHONY. In the meantime, you chose not to pay taxes.

Mr. WITNESS. I had no choice.

Mr. ANTHONY. Oh, you had a lot of choices. You could have kept doing what you had been doing for 20 years. The truth of the matter is you started violating the law.

Mr. WITNESS. No question. I don't want you to think I was without sin.

Mr. ANTHONY. What were some of your personal motivations and after 20 years of paying the legal excise taxes to start evading them?

Mr. WITNESS. Financially.

Mr. ANTHONY. Were there any others involved in your company that benefited financially?

Mr. WITNESS. Yes.

Mr. ANTHONY. Were you the primary beneficiary of this illegal activity?

Mr. WITNESS. I would say I was the primary beneficiary at that time, yes.

Mr. ANTHONY. How did your personal lifestyle improve after you began avoiding the payment of the excise tax?

Mr. WITNESS. That didn't change. More or less, enabling the company to meet expenses.

Mr. ANTHONY. You plowed it back into the company itself?

Mr. WITNESS. Yes, I did. After a time, we were making such substantial profits and the organized crime people were involved, naturally my lifestyle improved.

Mr. ANTHONY. After organized crime figures became involved?

Mr. WITNESS. Yes, sir; it did.

Mr. ANTHONY. Tell me exactly how organized individuals approached you.

Mr. WITNESS. First they tried to purchase my company. That was not possible, and I went to the authorities, and I got no response.

Mr. ANTHONY. When you went to the authorities about the approachment from the organized crime figures, you had already begun your illegal activities of evading excise taxes; is that correct?

Mr. WITNESS. No, sir; not at that time.

Mr. ANTHONY. You did not, personally, get involved until after the organized crime figures came to purchase your company?

Mr. WITNESS. That is correct.

Mr. ANTHONY. Did you eventually join together?

Mr. WITNESS. Yes, I did.

Mr. ANTHONY. You did not evade the taxes until you were in cahoots, in partnership with organized crime figures?

Mr. WITNESS. That is correct.

Mr. ANTHONY. Were they organized crime figures who were known to law enforcement officials?

Mr. WITNESS. Yes.

Mr. ANTHONY. Did this cast a great deal of suspicion upon your personal integrity and character?

Mr. WITNESS. Yes, it did.

Mr. ANTHONY. Did that incite the authorities to do an investigation of you, such as wiretaps, telephone taps?

Mr. WITNESS. I don't know what incited them.

Mr. ANTHONY. You don't know how they gained that information about you, yet after organized crime figures became involved with you, you say your operation was so profitable that your personal lifestyle tremendously improved?

Mr. WITNESS. Yes, sir; I did.

Mr. ANTHONY. In what way?

Mr. WITNESS. Traveling.

Mr. ANTHONY. Bigger houses, bigger cars, more cash in your pocket to spend?

Mr. WITNESS. Yes, sir.

Mr. Anthony. During the time you were in partnership with organized crime figures, did you establish more than this one wholesale distributor?

Mr. Witness. Yes.

Mr. Anthony. You described to Mr. Schulze the daisy chain operation, fictitious or bogus companies just for the purpose of drumming up fake invoices to avoid paying State and Federal taxes? Did you establish those types of companies?

Mr. Witness. Yes, I did.

Mr. Anthony. How many?

Mr. Witness. Maybe 50; just a guess.

Mr. Anthony. This would be to leave a paper trail of your gasoline transactions so it would be impossible to detect through audits?

Mr. Witness. That is basically correct.

Mr. Anthony. Was that the motivation in setting up the dummy companies?

Mr. Witness. Yes.

Mr. Anthony. Were you audited by the State officials?

Mr. Witness. Not that I recall.

Mr. Anthony. The IRS?

Mr. Witness. No.

Mr. Anthony. In your case, you were discovered because you were running around with known organized crime figures?

Mr. Witness. I guess that is a good assessment, yes.

Chairman Pickle. Well, I thought you also had gone to the FBI with this information.

Mr. Witness. Yes, I did. I went to them first.

Chairman Pickle. Then you changed your lifestyle?

Mr. Witness. Yes.

Mr. Anthony. That is a rather curious set of circumstances. Could you tell me what motivated you to become involved with organized crime figures. These are the people that you were so concerned about that you went to the Federal authorities. Where was the pressure point that made you do business with them after you had gone and alerted the authorities about this?

Mr. Witness. Two factions of organized crime. One faction tried to make a move to take control of my company, and another faction who stopped them from taking the control after I had gone to the FBI and I didn't get any action, I went to other organized crime people to stop the takeover.

Mr. Anthony. You went to a competing organized crime group?

Mr. Witness. Yes.

Mr. Anthony. Did that help?

Mr. Witness. Yes, they stopped the takeover attempt.

Mr. Anthony. In addition to doing the daisy chain, were you involved in bootlegging?

Mr. Witness. Yes.

Mr. Anthony. Were you involved in blending other legal stocks to avoid the taxes?

Mr. Witness. Yes.

Mr. Anthony. Were you involved in the use or sale of gasohol?

Mr. Witness. Yes.

Mr. ANTHONY. You were involved from A to Z. Any way you could get a tax-exempt status, collect the tax, not remit it, that was your modus operandi?

Mr. WITNESS. Yes.

Mr. ANTHONY. What was your understanding of why the organized crime figures wanted to be involved with you and others like you?

Mr. WITNESS. In my case, the motivation was trying to sell to my own service stations.

I formed a company with organized crime people—I am sorry—did you say what was the organized crime's motivation?

Mr. ANTHONY. Yes.

Mr. WITNESS. The money, the profits.

Mr. ANTHONY. They were able to capture a larger market?

Mr. WITNESS. Yes, sir.

Mr. ANTHONY. Obviously the more money they had the ability to make?

Mr. WITNESS. Yes.

Mr. ANTHONY. You started off in one State and expanded to how many States?

Mr. WITNESS. Four States.

Mr. ANTHONY. Did you expand further when you were indicted?

Mr. WITNESS. Yes.

Mr. ANTHONY. Your plans were to go nationwide?

Mr. WITNESS. Yes.

Mr. ANTHONY. In summarizing what you have said to me and other members of the committee, is it safe to say there is enormous profits to be made in the evading of excise taxes, gasoline, diesel, and aviation fuel?

Mr. WITNESS. Yes, sir.

Mr. ANTHONY. Based on your personal experience, is it safe to say there is an extreme lack of State and local effort in stopping this illegal activity?

Mr. WITNESS. Yes.

Mr. ANTHONY. And, therefore, you would say, based on your knowledge, that there is a great need for improved legislation on the Federal level, as well as the State level?

Mr. WITNESS. Yes, extremely needed.

Mr. ANTHONY. Extremely needed?

Chairman PICKLE. And what would you recommend? What steps would you recommend that we might do?

Mr. WITNESS. As I said earlier, Mr. Chairman, if there is a way to legislate the collection of the tax estimator refiner level.

Chairman PICKLE. On the first point——

Mr. GUARINI. If the chairman would yield.

You have testified that the majors know that these crimes are being committed, the evasion of these excise taxes, and yet did nothing about it.

Could this evasion of excise tax happen without the tacit contents of the major oil companies?

Mr. WITNESS. I can't see how. The major oil companies supply all the gasoline in this country.

Mr. GUARINI. If they were responsible as corporate citizens and law-abiding companies, and knew that there were crimes being perpetrated and stopped them from being committed, we wouldn't be in the fix that we are in now as to the evasion of gasoline excise taxes?

Mr. WITNESS. That is correct, sir. Yes.

Mr. GUARINI. The final ball could be rested on the shoulders of the major oil companies that are allowing this to happen to the American public and the American Government?

Mr. WITNESS. Yes, sir. That is correct.

Chairman PICKLE. The Chair appreciates the appearance of the witness.

I want to make it clear that your statement that political contributions were made to political figures has no bearing at all with respect to the bootlegging, daisy chains, just routine contributions, no intention to say there was any contention with the political contributions, regardless of whom it might be.

I don't want the record to indicate there might be some political influence. If there is, you ought to say so. If not, let's make sure that is an irrelevant position.

Mr. WITNESS. That is true regarding Governor Cuomo; yes, sir.

Chairman PICKLE. Do you know whether there are others?

Mr. WITNESS. One moment, please. I apologize.

In the case of the Carey thing I discussed before, the hazardous waste, that Martin Carey was making, the proceeds from that, and the profits from that were funneled into Governor Carey's campaign for reelection, 1978.

Chairman PICKLE. Has that been established or just an assumption on your part?

Mr. WITNESS. I was associated closely with Martin Carey, and this was what Martin Carey was doing with the funds.

Chairman PICKLE. Any other individuals that you recall?

Mr. WITNESS. That is just that one specific, Mr. Chairman.

Mr. GUARINI. I understand there is no aspersion cast upon Mr. Cuomo and his name unfortunately had come up, but there is no influence or no allegation of any kind regarding the good Governor of the State of New York?

Mr. WITNESS. That is correct.

Mr. GUARINI. One question. Sixty percent of the New York City Port Authority traffic is in petroleum products, a tremendous amount of petroleum products enter the country at the port authority.

Is there any monitoring of these products in these tankers that come with their goods and petroleum products into the United States? Does Customs monitor at all these particular products?

Mr. WITNESS. Monitoring is very poor. A cargo could come in labeled as naphtha, sold as motor fuel, the taxes collected and no one would be looking for those taxes.

Mr. GUARINI. The U.S. Customs doesn't do their job either seeing that accounting is made as to a particular country.

The IRS has been neglectful, but also there are other agencies within our Government that have to tighten up.

Mr. WITNESS. Coordination between the two. If Customs would report to IRS the arrival of a petroleum product, they would then be looking for the taxes on that product.

Chairman **Pickle**. Thank you very much, Mr. Witness. I thank your attorneys.

The Chair announces a 5-minute recess, and we will ask everyone in the room to please leave.

This will be only 5 minutes, if you will just do it quickly.

Also, I request that all the cameras now be turned to the back wall, and not to the front. Would you turn your cameras.

I appreciate your cooperation very much.

We don't like to make this request, but this is the agreement we had with the witness, as we set these hearings up, so we will recess now for 5 minutes.

[Brief recess.]

Chairman **Pickle**. The committee will come to order. Take your seats and please refrain from talking.

Our first panel will be testimony by Mr. Mark Richard, Deputy Assistant Attorney General of the Criminal Division, Department of Justice.

Mr. Richard.

Next will be Mr. Anthony E. Daniels, Deputy Assistant Director, Criminal Investigative Division, Federal Bureau of Investigation.

Mr. Richard, would you please identify the person with you.

STATEMENT OF MARK M. RICHARD, DEPUTY ASSISTANT ATTORNEY GENERAL, CRIMINAL DIVISION, U.S. DEPARTMENT OF JUSTICE, ACCOMPANIED BY JERRY D. BERNSTEIN, SPECIAL ATTORNEY, ORGANIZED CRIME STRIKE FORCE, U.S. DEPARTMENT OF JUSTICE; AND JOHN MICHAEL RYAN, ASSISTANT ATTORNEY GENERAL, STATE OF NEW YORK AND SPECIAL ASSISTANT U.S. ATTORNEY

Mr. **Richard**. On my immediate right is Jerry Bernstein, Special Attorney with the Organized Crime Strike Force in Brooklyn and on his right is John Michael Ryan, assistant attorney general for the State of New York who is being cross designated as a special assistant, U.S. attorney.

Chairman **Pickle**. We are glad to have all of you gentlemen here.

Mr. Richard, please proceed with your testimony.

Mr. **Richard**. Thank you, Mr. Chairman.

With your permission, I would submit my formal statement for the record and merely summarize it at this moment.

I am pleased to be here today to address the role of the U.S. Department of Justice in combating the emerging national problem of evasion of taxes on the sale of gasoline products; that is, the distribution of so-called bootleg gasoline.

Since it has been such a lucrative area, the sale of bootleg gasoline has in fact attracted assorted organized crime elements in at least the States of New York, New Jersey, and Florida.

Let me explain just why this form of tax evasion may become a problem of true national dimension.

A distributor of gasoline is required by law to collect, account for, and pay over to the U.S. Federal Government gasoline excise taxes in the amount of $.09 per gallon of gasoline sold on each sale of gasoline to a purchaser not holding a valid registration for tax-free transactions certificate. A distributor of gasoline selling gasoline to a purchaser holding such a valid registration for tax-free transactions is by law allowed to make a tax-free sale. That is, the distributor making the sale is not required to collect from the purchaser the $.09 per gallon of gasoline in Federal excise tax on the transaction.

In addition to the Federal tax imposed on each gallon of gasoline sold, various State and local taxes are also levied, and the distributor is also not required to collect these various State and local taxes from the purchaser, if the purchaser holds State and local certificates permitting a tax free sale.

The mechanism by which the bootlegger avoids the payment of taxes is by setting up a daisy chain of corporations, each of which holds a certificate allowing it to purchase the gasoline tax free. The bootlegger makes a series of paper or computer transfers of the gasoline from one corporation to the next until final liability for the taxes owed is placed upon a company which is nothing more than a corporate "shell" referred to as the "burn out company." In fact, the gasoline itself never physically changes hands.

The burn out company then sells the gasoline to the retailers, supplying the retailers with invoices marked "all taxes paid." In fact, these taxes have not been paid. When the taxing authorities seek to collect the taxes owed from the burn out company at the end of the daisy chain, they find only a shell corporation that has gone into bankruptcy. The burn out company frequently consists of only a telephone, mailing address, and a corporate principal who is an illegal alien acting as a straw man or an individual operating under an alias.

In November 1982, the chief law enforcement agencies on Long Island joined together in an historic alliance to battle the problem of gasoline bootlegging in that region and its infiltration by organized crime.

A task force was formed consisting of the Organized Crime Strike Force for the Eastern District of New York, the U.S. Attorney's Office for the eastern district of New York, the Suffolk County District Attorney's Office, the Office of the Attorney General of the State of New York, the Office of the Attorney General of the State of New Jersey, and various Federal and State law enforcement agencies, including the Federal Bureau of Investigation, Internal Revenue Service, New York State Department of Taxation and Finance, and investigators and police officers from Suffolk County and Nassau County. This task force of investigators and prosecutors became a model of cooperative law enforcement and yielded prodigious results.

Following 2 years of painstaking investigation, the task force indicted and convicted Lawrence Iorizzo for his bootlegging activities. Just before sentencing, Iorizzo fled the country by private jet for Panama, at the direction of his organized crime boss, Michael Franzese.

Iorizzo remained in hiding in his Panamanian villa for the next 4 months, from where he continued to direct his bootlegging activities.

Finally, Iorizzo was captured, returned to this country, and incarcerated, at which point he became a federally protected witness.

From his jail cell, Iorizzo explained to task force investigators how the bootleg gasoline scheme worked. With his testimony, the task force convicted two of Franzese's most trusted associates, Louis Fenza, and Frank Castagnaro, of grand larceny charges in county court, Suffolk County.

Finally, in a 99-page indictment, the strike force in the eastern district of New York indicted Michael Franzese and 8 of his associates in a far-reaching racketeering and tax conspiracy indictment. Included in this indictment, were some of Franzese's activities with Iorizzo in the bootleg gasoline business.

The indictment charged Franzese and his coconspirators with having plundered millions of dollars in unpaid gasoline tax moneys through Iorizzo's companies. It went on to show how Franzese and his coconspirators took these moneys and laundered them through several of Franzese's motion picture distribution companies in Florida and California. Franzese's bootleg gasoline activities with Iorizzo included New Jersey and Florida, as well as New York.

Following his indictment in December 1985, the Brooklyn Strike Force succeeded in having Franzese incarcerated under the new Federal pretrial detention statute, as a danger to the community.

Finally, in March of this year, Franzese threw in the towel and pled guilty to racketeering and tax conspiracy charges. As part of the guilty plea, Franzese agreed to be sentenced to a 10-year prison term and to make nearly $15 million in fine, forfeiture and restitution payments to the Government.

Ten million dollars of this money is specifically earmarked as restitution payments for Franzese's gasoline bootlegging activities and is to be divided among the victims of Franzese's frauds: The Federal Government, New York State, New Jersey, and Florida.

Also pleading guilty to racketeering and tax conspiracy charges with Franzese were three of his henchmen in the illegal bootlegging activities: Frank Cestaro, Louis Fenza, and Frank Castagnaro. They all received substantial prison terms as part of their guilty pleas.

To date, the task force has been responsible for additional Federal, State, and county convictions of other gasoline bootleggers.

Currently pending are indictments of several other gasoline bootleggers, in cases involving over $40 million in unpaid taxes. The task force investigation is continuing and more indictments are expected shortly.

That concludes my summary of my prepared remarks and I will be glad to entertain any questions you might have.

[The prepared statement follows:]

STATEMENT

OF

MARK M. RICHARD
DEPUTY ASSISTANT ATTORNEY GENERAL
CRIMINAL DIVISION

My name is Mark Richard. I am Deputy Assistant Attorney General of the Criminal Division of the Department of Justice and I will be presenting this testimony on behalf of the Criminal Division. With me is Jerry D. Bernstein, Special Attorney with the Organized Crime Strike Force in Brooklyn, New York, and John M. Ryan, Assistant Attorney General of the State of, New York, who has been cross-designated as a Special Assistant United States Attorney. I am pleased to be here today to address the role of the United States Department of Justice in combatting the emerging national problem of evasion of taxes on the sale of gasoline products, that is the distribution of so-called "bootleg" gasoline. To begin with, the sale of bootleg gasoline has been estimated to cost the federal and state governments hundreds of millions of dollars in lost revenues. Furthermore, since it has been such a lucrative area, the sale of bootleg gasoline has attracted assorted organized crime elements, in at least New York, New Jersey, and Florida. These criminal elements have made millions of dollars by attaching themselves to successful gasoline bootleggers. One such organized crime figure is Michael Franzese, boss of an independent faction of the Colombo Organized Crime Family on Long Island. Franzese took Lawrence Iorizzo under his wing and made Iorizzo's companies part of the Franzese empire. Organized crime figures, such as Franzese, provide the muscle to enable the gasoline bootleggers to operate in the market place with impunity and to intimidate their competitors. Before detailing the Justice Department's efforts at prosecuting both the bootleggers and their organized crime overlords, let me explain just why this form of tax evasion may become a problem of national dimensions.

Methods of Bootlegging

A distributor of gasoline is required by law to collect, account for, and pay over to the United States federal gasoline excise taxes in the amount of $.09 per gallon of gasoline sold, on each sale of gasoline to a purchaser not holding a valid Registration for Tax Free Transactions (IRS Form 637). A distributor of gasoline selling gasoline to a purchaser holding such a valid Registration for Tax Free Transactions (IRS Form 637) is allowed by law to make a "tax free" sale, that is, the distributor making the sale is not required to collect from the purchaser the $.09 per gallon of gasoline in federal excise tax on the transaction. In addition to the federal tax imposed on each gallon of gasoline sold, various state and local taxes are also levied. The distributor is also not required to collect these various state and local taxes from the purchaser if the purchaser holds state and local certificates permitting a "tax free" sale. In New York, for example, the state equivalent for the IRS Form 637 is called an "M number".

The total of these various federal, state and local taxes, therefore, can potentially account for as much as 40 percent of the retail sales price of a gallon of gasoline. As a result, there is tremendous incentive for "gasoline bootleggers" to evade payment of these taxes. In New York, for example, the total tax on one gallon of gasoline is approximately $.27. Thus, tax evasion on the sale of a barge load of gasoline, approximately one million gallons of gasoline, represents a criminal profit of approximately $270,000. Local authorities in New York estimate that, until recent changes in the state law, as much as 30 percent of the retail gasoline market in the New York Metropolitan Area was controlled by bootleggers.

The mechanism by which the bootlegger avoids the payment of taxes is by setting up a "daisy chain" of corporations, each of which holds a certificate allowing it to purchase the gasoline "tax free." The bootlegger makes a series of paper or computer transfers of the gasoline from one corporation to the next until final liability for the taxes owed is placed upon a company which is nothing more than a corporate "shell" - referred to as the "burn out company." In fact, the gasoline itself never physically changes hands.

The "burn out company" then sells the gasoline to the retailers, supplying the retailers with invoices marked "all taxes paid." In fact, these taxes have not been paid. When the taxing authorities seek to collect the taxes owed from the "burn out company" at the end of the daisy chain, they find only a "shell" corporation that has gone into bankruptcy. The "burn out company" frequently consists of only a telephone, mailing address, and a corporate principal who is an illegal alien acting as a "strawman" or an individual operating under an alias.

In order to further confound the taxing authorities, the "daisy chain" is sometimes varied so that the "burn out company" is in the middle, rather than at the end of, the "daisy chain" of corporations. In this and other ways, the schemes to evade taxes on gasoline sales have become increasingly sophisticated as legislative changes are effected and law enforcement becomes more aware of the activities of bootleggers. Firms currently engaged in bootlegging must now, of necessity, create entire systems of false and fraudulent invoices, bills of lading, delivery tickets, disbursement records, etc., to conceal their tax evasion activities. These records, often including computer printouts, false financial statements, and other documents, are then distributed to participants in the scheme, such as retailers and other distribution networks, to insure that the records of the co-conspirators "jive," in order to avoid detection and prevent prosecution.

A bootlegger's control of the market is solidified, of course, if he has an organized crime affiliation and because he can sell the untaxed gasoline for much less than his legitimate competitors. This gives the bootlegger an unfair competitive advantage over legitimate dealers.

Law Enforcement Efforts

In November 1982, the chief law enforcement agencies on Long Island joined together in an historic alliance to battle the problem of gasoline bootlegging in that region and its infiltration by organized crime. A Task Force was formed consisting of the Organized Crime Strike Force for the Eastern District of New York, the United States Attorney's Office for the Eastern District of New York, the Suffolk County District Attorney's Office, the Office of the Attorney General of the State of New York, the Office of the Attorney General of the State of New Jersey, and various federal and state law enforcement agencies, including the Federal Bureau of Investigation, Internal Revenue Service, New York State Department of Taxation and Finance and investigators and police officers from Suffolk County and Nassau County. This Task Force of investigators and prosecutors became a model of cooperative law enforcement and yielded prodigious results.

Following two years of painstaking investigation, the Task Force indicted and convicted Lawrence Iorizzo for his bootlegging activities. Just before sentencing, Iorizzo fled the country by private jet for Panama, at the direction of his organized crime "boss," Michael Franzese. Iorizzo remained in hiding in his Panamanian villa for the next four months, from where he continued to direct his bootlegging activities. Finally, Iorizzo was captured, returned to this country, and incarcerated, at which point he became a federally protected witness. From his jail cell, Iorizzo explained to Task Force investigators how the bootleg gasoline scheme worked. With his testimony, the Task Force convicted two of Franzese's most trusted associates, Louis Fenza and Frank Castagnaro, of grand larceny charges in County Court, Suffolk County.

Finally, in a ninety-nine page indictment, the Strike Force in the Eastern District of New York indicted Michael Franzese and eight of his associates in a far-reaching racketeering and tax conspiracy indictment. Included in this indictment, were some of Franzese's activities with Iorizzo in the bootleg gasoline business. The indictment charged Franzese and his co-conspirators with having plundered millions of dollars in unpaid gasoline tax monies through Iorizzo's companies. It went on to show how Franzese and his co-conspirators took these monies and laundered them through several of Franzese's motion picture distribution companies in Florida and California. Franzese's bootleg gasoline activities with Iorizzo included New Jersey and Florida, as well as New York.

Following his indictment in December 1985, the Brooklyn Strike Force succeeded in having Franzese incarcerated under the new Federal pretrial detention statute, as a danger to the community. Finally, in March of this year, Franzese threw in the towel and pled guilty to racketeering and tax conspiracy charges. As part of the guilty plea, Franzese agreed to be sentenced to a ten year prison term and to make nearly fifteen million dollars in fine, forfeiture and restitution payments to the government.

Ten million dollars of this money is specifically earmarked as restitution payments for Franzese's gasoline bootlegging activities and is to be divided among the victims of Franzese's frauds: the federal government, New York State, New Jersey and Florida. Also pleading guilty to racketeering and tax conspiracy charges with Franzese were three of his henchmen in the illegal bootlegging activities: Frank Cestaro, Louis Fenza and Frank Castagnaro. They all received substantial prison terms as part of their guilty pleas.

To date, the Task Force has been responsible for additional federal, state and county convictions of other gasoline bootleggers including, Charles Forthmuller, Louis Paduano, Bernard Short, and Martin Diaz. These convictions were for several million dollars in bootleg gasoline activities. Currently pending, are indictments of several other gasoline bootleggers, in cases involving over $40 million in unpaid taxes. The Task Force investigation is continuing and more indictments are expected shortly.

These most recent prosecutions are significant because they include individuals associated with traditional organized crime families, as well as bootleggers associated with emerging organized crime groups, including a group of Russian immigrants active in Brooklyn. These Russian bootleggers have been moving to take over a larger share of the market, but not without incident. Three murders of Russian bootleggers are currently under investigation by the Task Force.

With the example set by the Task Force in New York, the Justice Department expects that similarly successful prosecutions will be brought in other parts of the country.

Recommendations

While I believe that specific recommendations for any planned remedial actions are best left to those more familiar with the economic and other consequences of changing the present regulatory and tax systems, the Department of Justice believes that this Committee should examine and consider for one thing, the collection of federal excise taxes at the refinery or importation level.

I understand that representatives from the Department of the Treasury will be providing more detailed recommendations.

This concludes my prepared statement. I am happy to answer any questions the Committee might have.

Chairman PICKLE. Thank you.
Mr. Daniels.

STATEMENT OF ANTHONY E. DANIELS, DEPUTY ASSISTANT DIRECTOR, CRIMINAL INVESTIGATIVE DIVISION, FEDERAL BUREAU OF INVESTIGATION

Mr. DANIELS. Thank you, Mr. Chairman.

I am pleased to appear before the subcommittee to testify concerning the FBI's experiences with respect to evasion of Federal gasoline excise taxes.

At the outset, I will note that the primary responsibility of enforcing the Federal excise tax law lies with the Internal Revenue Service. The FBI's jurisdiction derives from the infiltration and control of the independent gasoline industry by traditional and nontraditional organized crime figures. Our investigation has been conducted under the Federal RICO statute, which includes as predicate offenses violations such as mail fraud, fraud by wire, conspiracy, obstruction of justice and bankruptcy fraud. Through the use of the Federal grand jury, the investigative effort has melded the Criminal Investigation Division of the Internal Revenue Service and special agents of the FBI into an extremely effective unit to combat organized crime's influence within this industry.

Chairman PICKLE. Mr. Daniels, I will have to ask you to speak into that microphone. We are having a little difficulty hearing you up here.

Mr. DANIELS. The FBI initiated an investigation of traditional organized crime infiltration of the independent gasoline distribution industry on Long Island in 1981. This investigation led to the formation, in November 1982, of the Long Island Organized Crime Task Force. The task force was comprised of representatives of the Federal Bureau of Investigation; Internal Revenue Service; the U.S. Attorney's Office, eastern district of New York; the Joint Organized Crime Strike Force, Brooklyn, NY; the offices of the New York State Attorney General; the police departments and District Attorney's Office of Nassau and Suffolk Counties; and the New York State Department of Tax and Finance. The FBI coordinated this investigation.

From its inception, the task force utilized the Federal grand jury and New York State grand juries to help achieve its goal, namely, the elimination of organized crime's control of the independent gasoline industry in New York State. Currently, there are multiple Federal and State grand juries hearing testimony in this matter. In view of the various restrictions against disclosing information obtained through the Federal and State grand juries, and because of the pending nature of the investigation, my testimony must be limited.

The precise scope of the gasoline excise tax evasion problem is unknown at this time. To arrive at an estimate of the Federal excise tax loss, the FBI must necessarily rely on the information provided by cooperating government witnesses, various tax loss estimated by Federal and State taxing officials, industry estimates, and of course, the evidence gathered to date by the Long Island Organized Crime Task Force. Most companies investigated by the task force were stealing both Federal and State taxes. Investigators participating in this task force investigation conservatively estimate the loss of revenues to exceed $500 million to date in Federal excise taxes nationwide.

The investigation of bootleg gasoline schemes—that is the gasoline which is sold to the consumer without any Federal or State taxes being paid—in New York State has uncovered similar schemes in New Jersey, Connecticut, Florida, Pennsylvania, and Massachusetts. Dummy companies have been formed in Texas, Colorado, California, Nevada, and Delaware in support of the various schemes.

The task force has learned that dummy corporations were also formed in Panama and Austria to aid in secreting and laundering funds derived from this scheme. The Colombo, Genovese and Luchese organized crime families in the New York area now control a substantial portion of the independent gasoline distribution industry and are active participants in bootleg gasoline schemes. Additionally, other ethnic organized crime elements are heavily involved.

In the past few months, a number of shootings within this group have been directly linked to efforts to solidify their control of a portion of this industry. Foreign nationals are frequently used as front men in shell companies that organized crime figures intend to burn; that is, to use as the final company responsible for payment of the Federal and State taxes. In several instances, by the time millions of dollars in tax evasion was discovered, the principals of the burn companies had already returned to their native countries.

Organized crime families have become involved in the gasoline industry in a variety of ways, such as extortion, threat and loan shark loans. One instance involved Lawrence Iorizzo, who at one time was the kingpin in this industry and operated a tax evasion scheme.

Iorizzo was approached and taken over by Michael Franzese, a member of the Colombo LCN family. Iorizzo, and later Franzese, were convicted of Federal charges related to this scheme. Iorizzo is cooperating with the Government and is currently in the Witness Security Program.

Successful operation of the scheme depended on acquisition or control of Federal excise tax exemption numbers, commonly known as 637's, as well as New York State or other State exemption numbers. Control of these exemptions allow the tax liability to be passed from tax-exempt distributor, to tax-exempt distributor, in a daisy chain fashion until the paperwork shows the product sold to the burn company, which in most cases has a 637 exemption and a State tax exemption. The tax liability rests with the last tax-exempt distributor. This burn company then sells the product to a nontax-exempt distributor or retailer, invoicing the product as all taxes paid. In most cases, the product or gasoline does not move from terminal to terminal, as the paperwork or supporting document will simply change hands. In some of these cases, the paperwork will not move out of an office due to the fact that a number of these dummy corporations are controlled within that office. In New York State, the State tax amounts to 18 cents a gallon, and of course, the Federal tax is 9 cents.

By losing the tax liability, the organized crime consortium can avoid as much as $20 or $30 million of taxes due on one burn company. A 637 exemption obtained by a company is good anywhere in the country. Many States issue State exemptions to out-of-State entities. We have seen a California company, for example, apply for and receive a 637 in Texas. The company then buys products from a New York company, registered in New Jersey, but takes delivery elsewhere. There are many variations of the basic daisy chain scheme, but ultimately they can only work with the 637 exemption certificate. Without the 637, these companies could not purchase tax-exempt gasoline. The Michael Franzese-Lawrence Iorizzo conspiracy involved multiple burn or dummy companies, and hundreds of millions of dollars in actual tax losses.

The Organized Crime Task Force has been a highly effective tool in combating this very sophisticated crime problem. There are currently some 30 investigators from 8 agencies working on these investigations. There are nine local, State, and Federal prosecutors preparing these cases for indictment and prosecution. State and local prosecutors have been cross-designated by the Justice Department. This investigation demonstrates that a coordinated effort can be accomplished and be ultimately successful.

To date, there have been 11 Federal and State convictions. An additional 12 indictments have been returned. It is anticipated that additional indictments will be returned. Through the efforts of the task force, $11 million in criminal proceeds was located in Austria and returned to creditors defrauded by Mr. Iorizzo.

The FBI, with the assistance of the Internal Revenue Service, is attempting to determine other areas of the country in which traditional and nontraditional organized crime groups might be controlling excise tax evasion. Our efforts will be focused on areas of the country where there is a concentration of organized crime members and associates. Continued close cooperation between the FBI and the Criminal Investigation Division of the Internal Revenue Service through the Federal grand jury is considered essential.

The FBI will defer to others with respect to recommendations or revisions that relate to the collection or enforcement of the Federal gasoline excise tax.

Mr. Chairman, this completed my prepared remarks. I will be happy to answer any questions.

Chairman PICKLE. Thank you, Mr. Daniels.

The organized crime task force that you have reference to, apparently is attempting to combat this difficulty, this problem. As I understand your testimony, you have 30 investigators from 8 different agencies working in this area.

Is that nationwide?

Mr. DANIELS. No, sir, that is just in the New York area.

Chairman PICKLE. Just in the New York area.

Mr. DANIELS. Yes, sir.

Chairman PICKLE. Do you have similar numbers in other parts of the country yet, or are you starting it in New York now?

Mr. DANIELS. We are just starting in New York. We anticipate educating our additional field offices where we have an organized crime element, to the fact that this problem does exist, and we will.

Chairman PICKLE. Mr. Richard, do you have any prosecutions underway now in any part of the country?

Mr. RICHARD. Other than under the auspices of the task force based in New York, no, none at the moment. We have numerous investigations as indicated. In our judgment, we have developed a successful model for dealing with the problem, once we can identify that the problem exists in other locations and other parts of the country, so we are prepared to move in a similar vein if there are factual basis for doing so.

Chairman PICKLE. I appreciate you saying you are prepared. You have the conviction of this Mr. Iorizzo and Mr. Franzese, as well as, according to your testimony, Mr. Forthmuller, Louis Paduano, Bernard Short, and Martin Diaz. You have had convictions in those areas, but your suits now are only in the New York area.

Do you have any in court that you are prosecuting on trial at this point?

Mr. RICHARD. There are prosecutions pending, but as I tried to indicate, it is in the context of the current effort based in New York, but there are prosecutions there.

Chairman PICKLE. Prosecutions pending in the New York area.

Mr. RICHARD. Yes, sir.

Chairman PICKLE. One, two, three, a lot of them? This seems very vague. You say we are prosecuting it, following it. To what extent?

Mr. RICHARD. There are two current prosecutions pending involving four individuals at the moment.

Chairman PICKLE. Now, the subcommittee's first witness, who appeared a few minutes ago—were you in the room?

Mr. RICHARD. Yes, I was, Mr. Chairman.

Chairman PICKLE. He has provided us with a list of the States where he says he knows gasoline taxes are being evaded, openly, defiantly and easily, or words to that effect. The States he listed would be New York, New Jersey, Florida, Texas, Oregon, Nevada, California, Louisiana, Georgia, North Carolina, and South Carolina.

In either your testimony or Mr. Daniels' testimony, you have said that you have investigations underway in Colorado and in Delaware, and that you have sent someone to investigate Panama and Austria. Is this list of States that I have read to you accurate? I assume that the Justice and the FBI knows of the evasions in these States.

Do you question this list? Do you accept it as being accurate or do you know?

Mr. RICHARD. Sir, I have no basis to take exception to that aspect of Mr. Iorizzo's testimony, but I would point out that the degrees of vulnerability vary from State to State.

Chairman PICKLE. What other States are involved that might be not on this list I have read to you? Are you investigating other States? Do you have some States that are really under investigation at this point on this evasion question?

Mr. RICHARD. No, Mr. Chairman.

Chairman PICKLE. Well, what is being done then in these various States to put a stop to this? If you have no investigations going on in these 10, 12 States, then I assume that nothing is being done other than you just recognize there is a problem?

Mr. **Richard**. No, sir, Mr. Chairman. I think the first line of attack is to disseminate the results of our experience in the New York area to the relevant regulatory enforcement agencies, both at a Federal and State level, and this is what we are doing through the IRS, through, as Mr. Daniels indicates, through the FBI, to ensure that all the appropriate regulatory agencies are aware of the profile of the problem, and are in a position to mount appropriate audit responses, and the like.

I think this is the first step that has to be taken, and it is my understanding that this step is being taken.

Chairman **Pickle**. I am encouraged that Mr. Daniels stated that 11 Federal and State convictions have been obtained as of now, and in addition, 12 indictments have been returned.

I know you have to start at some point. I am distressed that it was 1981, 1982, or 1983 that you really had gotten underway on this thing, and now this is 1986, and we only have 11 convictions.

That is in a scheme that is nationwide, rampant, and I am shocked that there hasn't been more specific action taken. Are you shorthanded in your personnel? Is that a problem for you? Do you need more help in this area, or do you need more concentration on it?

What should the Congress do about it?

Mr. **Richard**. Before rushing out and saying we need more resources, I would suggest, Mr. Chairman, that we have been moving aggressively, but as we tried to demonstrate during our testimony, these are extremely complex transactions, and they are structured in a way so as to frustrate an audit trail process, if you will.

In many aspects, they are international in scope intentionally designed to make it difficult to gather sufficient evidence to bring these cases into court.

I think we have developed a good enforcement model. I think we are prepared to utilize this model in an effective way, so I would not rush out and say we need more resources. I would say that we have certainly demonstrated that consideration should be given to remedial legislation which might make the obligation to collect the tax at an earlier point rather than at the end of the distribution chain, begin that obligation at the beginning of the chain.

Chairman **Pickle**. Well, Mr. Richard, that may be an approach. This committee is an investigative committee, and we are not in a position to recommend specific legislation. We may go that route, but at this point, we are trying to find out what is the scope of the problem.

Is this a national problem, or a regional problem?

Mr. **Richard**. I cannot definitively tell you at this point, Mr. Chairman, that we have an extensive number of separate and distinct conspiracies.

What we have are a series of conspiracies that are national in scope, the individual conspiracies. By that, I mean they utilize companies, located, chartered in different parts of the country, but whether we are dealing with 100 different conspiracies or just 5, I cannot at this point tell you.

I can tell you based on experience that there is vulnerability in various parts of the country to repetition of this scheme.

Chairman **Pickle**. I have read to you 12 different States as to which the first witness says tax evasion is rampant, and that this information has been given to either FBI or to Justice. Now to the extent you believe that convicted felon is one matter, and another matter is, if you have that information, it ought to be investigated.

I find it difficult to believe that the Justice Department or the FBI has been aggressively pursuing these violations, if you had 10 or 11 convictions over a period of 4 or 5 years.

You have either looked the other way, and it has been said by some, when you do look into it, you go after the little guy and not after the big guy, the Mafia. You do state that these Mafia families are involved, and that they control the retail outlets in many instances.

It is hard to say you are aggressively pursuing this when we have had such a small amount of action in the field and the losses are so heavy. The losses are somewhere in the neighborhood of $1 billion a year.

Mr. **Richard**. Whether it is $1 billion, $500 million, I can't say but they certainly are astronomical, I agree with you. In judging a war against organized crime, success is not necessarily based on numbers of convictions, but the quality of the cases brought, and our efforts are demonstrative of a commitment—an aggressiveness that has paid off.

We have made significant cases against significant organized crime figures, I would submit.

Chairman **Pickle**. Well, we are going to have one witness testify, and we have seen the testimony, that there were investigative leaks in your organization, and in some instances, the persons employed by your strike force, some attorneys left the agency and went to work for a defendant.

Is this fact commonplace or has this happened, do you know?

Mr. **Richard**. Mr. Chairman, I am advised that in this particular prosecution, there were no leaks of information. However, I think, I appreciate your reference to former prosecutors going out representing other individuals.

I can tell you the instances that you have in mind do not reflect inappropriate conduct.

Chairman **Pickle**. We will give you the names and instances we have been advised of, and we would like you to comment to us in writing. One more thing, I think Mr. Guarini asked about the major oil companies, and some of the witnesses suggest that at the very minimum, the major oil companies are aware of the large-scale evasion schemes, and that excise tax evasion is an accepted way of doing business and has been so for years.

Is that true, are any major oil companies under investigation for evasion of gasoline excise taxes?

First, are they aware of it? Are they just accepting it as a way of doing business?

Mr. **Richard**. Mr. Chairman, no, we have no hard evidence that major oil companies are aware and participating in perpetration of such schemes. This may be viewed as reality on the streets and in the industry.

I will not quarrel with that representation, but I cannot attest to its accuracy.

Chairman PICKLE. Well, you are saying, to your knowledge, the major companies are not aware of this?

Mr. RICHARD. To my knowledge.

Chairman PICKLE. You are a trusting soul.

Mr. GUARINI. Would the gentleman yield?

Do you have specific knowledge or you have investigated or you are saying to the committee that you have no concept. Do you have any basis to make any statement of fact, or is it that you have no basis for any opinion whatsoever?

Mr. RICHARD. Sir, we have no hard information that individuals located in the major companies are specifically aware of these operations. I am skeptical simply because this kind of practice may very well be known in segments of the industry.

Mr. GUARINI. You made no investigation one way or the other?

Mr. RICHARD. At this time, we have no investigation going.

Chairman PICKLE. Well, Mr. Richard and Mr. Daniels, I thank you for your testimony. I also am glad that Justice and the FBI is pursuing this. I would hope that you are indeed pursuing it aggressively. I find it hard to believe, though, that you said you are not sure that this is a national problem, but it might be, but at the same time, I have read you a list of some 12, 14 States all across the Nation, and so it is obvious it is not in just one part of the country.

It is everywhere. The problem is, to what extent? What is the scope of it, and then later, what can we do about it?

Mr. Schulze.

Mr. SCHULZE. Thank you, Mr. Chairman.

We heard a witness this morning who testified that he went to the authorities in 1979, to try to make them aware of this. Will you tell me exactly what happened in that instance and what happens when a citizen comes in to reports such an incident?

Mr. DANIELS. Congressman, to my knowledge, and I am very sketchy on this, so bear with me, Mr. Iorizzo first came to the FBI in 1979. In fact, he sent a representative to the FBI regarding an individual who was attempting to move in and take over his company.

He furnished us no information regarding this tax scheme at that particular time. We conducted an active investigation regarding his allegation, presented it to the strike force in Brooklyn and there was insufficient evidence at that time to sustain a prosecution.

A prosecution was declined. He later came back in 1980, and at that——

Mr. SCHULZE. Let me interrupt you for just a moment. He reported this in 1979, and the FBI fully investigated his allegation that somebody was trying to take over his business?

Mr. DANIELS. Yes, sir.

Mr. SCHULZE. All right. Was that reported back to him? How long did that take?

Mr. DANIELS. I would guess the investigation probably took anywhere from 6 months to a year, and that is just a guess, Congressman. I assume at that time, there was dialogue between the agents.

Mr. SCHULZE. He said he didn't hear from the FBI. I can understand the plight of an individual who is a businessman who feels illegal pressure to sell his businesses, and who doesn't think that the Government is going to help him.

I want you to either tell me that the FBI worked on this matter, or walked away from it. It has to be one or the other.

Mr. **Daniels**. We did not walk away from it. At the time, Mr. Iorizzo was under indictment on local charges.

Mr. **Schulze**. For what?

Mr. **Daniels**. Local charges. I believe he was under indictment at the time by local authorities, not Federal charges, for forging, bid rigging, and grand larceny. There was no contact, I am told, with Mr. Iorizzo, but the allegation was investigated.

There was insufficient evidence to sustain a prosecution and prosecution was declined.

Mr. **Schulze**. The only thing involved was somebody was trying to muscle in or take over his business?

Mr. **Daniels**. Yes, sir, that was his allegation.

Mr. **Schulze**. Did he have tapes?

Mr. **Daniels**. Yes, he did, and my understanding as far as the tapes were concerned, as far as the prosecutive opinion and maybe somebody here could speak for that, my understanding is that the threats were veiled, never carried out on, and there was a decision made that there was insufficient evidence at that time.

When he came back to the FBI personally——

Mr. **Schulze**. Mr. Daniels, I think most criminals today are somewhat sophisticated and if the average businessman walks in, the threats are going to be veiled. Are you saying to these people, don't go to the FBI, because they are not going to be able to do anything?

Mr. **Daniels**. Congressman, the FBI is an investigative agency. We do not render prosecutive opinions. We gather the facts and present them to the appropriate U.S. attorney's office or strike force and get a prosecutive opinion. That is what was done in this case.

Mr. **Schulze**. So you are saying don't go to the FBI?

Mr. **Daniels**. No, sir.

Mr. **Schulze**. Could you be more explicit.

Mr. **Daniels**. We conducted an investigation based on the allegation made, presented the facts to the strike force in Brooklyn, and prosecution was declined by the strike force.

Mr. **Schulze**. Prosecution was declined because there was insufficient evidence, or because in your opinion or the opinion of the FBI, there was sufficient evidence but the strike force was busy with other things?

Mr. **Daniels**. No, sir.

Mr. **Richard**. May I interject for a moment?

Mr. Bernstein, I believe, may have some information on that process. Mr. Bernstein, with the strike force, may have some information relevant to your question. And, with your permission, possibly he can answer your question.

Mr. **Schulze**. I am concerned about the impression we are leaving. It seems that the impression we are leaving is that if a businessman goes to the authorities, he doesn't get much response. I would like to clear up that impression.

Mr. **Bernstein**. Mr. Schulze, if I might, for a moment, when Mr. Iorizzo came forward initially in 1979 or 1980, thereabouts, he certainly did not come to the authorities with clean hands, and he was not a legitimate businessman operating in the community who was being victimized by criminal elements, who was looking for the help of law enforcement to assist him with his problems. He was an individual who had his own legal problems at the time with local law enforcement, and was essentially looking to help himself out.

I think it is clear even from his testimony this morning that Mr. Iorizzo was not ready to make a clean breast of the activities he was involved with, and was on the verge of getting involved in much, much more massive tax evasion and bootlegging schemes.

Mr. **Schulze**. In your opinion, had he been a legitimate businessman for 20 years, or had he not?

Mr. **Bernstein**. I don't know what he was doing 15 or 20 years ago.

Mr. **Schulze**. He said he had been in the oil business for about 20 years.

Was his involvement with illegal activity a gradual process, in your opinion, or was it something with which he decided to become involved all of a sudden.

Mr. **Bernstein**. I don't know how sudden it was. I think that he became involved certainly through the late seventies and into the eighties with various organized criminal elements, and I think the point is that when he came to law enforcement it was not really to help himself out and rid himself of these criminal elements so he could go back to being a legitimate businessman.

To the extent he may have left that impression this morning, I think that would be inaccurate, not that he testified falsely but that impression might be an inaccurate one.

Mr. **Schulze**. The question tax evasion in his business was not a matter of discussion at that time.

Was there reason for the task force to get involved with the issue of tax evasion at that time?

Mr. **Bernstein**. That wasn't the nature of his complaint. I think it wasn't until a year or two later that the strike force and other law enforcement elements in the New York area began to focus in on the nature of the problem that we are facing in the New York area.

Mr. **Schulze**. Why did they start focusing on tax evasion as a problem?

Mr. **Bernstein**. I think it was as a result of information that was coming in from various sources through the FBI, through the State Attorney General's Office, through the Suffolk County Attorney General's Office.

Mr. **Schulze**. This was in 1981?

Mr. **Bernstein**. 1980, 1981, and 1982.

Then, the task force was formed, so that a joint effort could be made to address this problem.

Mr. Iorizzo was one of the prime targets of the task force from the outset.

Mr. **Schulze**. What kind of progress have we made?

Mr. **Bernstein**. We convicted Mr. Iorizzo, one of the main bootleggers.

Mr. **Schulze**. That was a million dollar scheme.

Are we following these leads? Are they leading to prosecutions?

Mr. **Bernstein**. Certainly we learned through the course of the investigation that Mr. Franzese and Mr. Iorizzo were involved in bootlegging activities, for example, in the States of Florida and New Jersey. We have made contact with prosecutors in those States, and have been involved in joint prosecution efforts with prosecutors in the States of New Jersey and Florida, as well.

Mr. **Schulze**. Tell me about diesel and aviation fuel. Have any of the investigations led into tax evasion of diesel and aviation fuel?

Mr. **Ryan**. Some of the investigations have led into the diesel fuel area. We have had very few at the time leading into the aviation fuel area.

Mr. **Schulze**. Are you just following the leads where they take you, or do you step back and look and say this is a problem with tax evasion and try to make quantum leaps to find out where the evasion is?

Mr. **Ryan**. What got us into this was the problem with gasoline. As we investigated gasoline, we found overlaps into the diesel fuel area. I have not seen overlaps into aviation fuel at this time.

Chairman **Pickle**. Mr. Guarini.

Mr. **Guarini**. Thank you, Mr. Chairman.

Is the focus of your strike force on organized crime, and you have stumbled into the tax excise fraud, or is the focus on the fraud of the gasoline excise tax?

Mr. **Richard**. If I may answer, that is one of the virtues of having a multifaceted task force. We have the organized crime components within the task force, but it is not exclusively an organized crime task force. The organized crime aspect is at the moment in New York of paramount interest, but the task force is capable and has in fact worked schemes, whether they involve traditional organized crime figures or not.

Mr. **Guarini**. Then, would the focus be more on bootleg gasoline, or would it be on the daisy chain operation, or would it be both?

Mr. **Bernstein**. I think the term "bootlegging" is a term that is used to include daisy chain operations, as well.

Mr. **Guarini**. I would use "bootleg" as that there is no record of it, and a lot of gasoline comes in from overseas, and there is a way of not having a record made, so that there would be no 637, and daisy chain would apply to the exemption certificates that people would apply to the IRS for.

Mr. **Bernstein**. The fact of the matter is that the two scenarios that you set forth really operate together, and that the term "bootleg" gasoline is a generic term used to describe this entire area of daisy chains and evasion, and so forth.

Mr. **Guarini**. Aren't they two different kinds of operations? One would be more illegal gasoline, and the other would be gasoline that would go through the process, but fraudulent statements are made to the IRS?

Mr. **Bernstein**. Not generally. They are generally combined as one operation.

Mr. GUARINI. Did you stumble on this as a way of convicting organized crime members of the underworld, organized crime, or is this a vehicle where if you can't successfully get the underworld criminal by way of the RICO statute that you would get them by way of tax evasion?

Mr. BERNSTEIN. No. Both things were happening at the same time. We were investigating the industry, and it was immediately obvious when investigators looked at what was happening in New York that organized crime was involved. We didn't stumble on either the tax evasion or the organized crime involvement. I think they both became known to us roughly about the same time.

I think there may be confusion about the names of the various groups involved. There is an office called the Organized Crime Strike Force, an entity that prosecutes a variety of different cases. There was formed in 1982 a group called the Oil and Gas Task Force, an ad hoc group that was comprised of, among other organizations, the Organized Crime Strike Force and other existing entities, such as various District Attorneys' Offices, the U.S. Attorney's Office, and various investigative agencies.

So, the Oil and Gas Task Force is to prosecute not just organized crime figures but all individuals involved in this area.

Mr. GUARINI. Do they investigate major oil companies or do they just stick to the organized crime operation?

Mr. BERNSTEIN. I think that the task force will investigate any individuals who are involved in this type of activity. They are not restricted to organized crime.

Mr. GUARINI. Have they gone after any major oil companies, to your knowledge?

Mr. RYAN. If I could answer that, I am not sure how you are defining "major oil company," but we have investigated oil companies larger than those thus far charged, and those investigations are continuing.

Mr. GUARINI. Have you investigated the seven oil sisters, the largest companies we have, that are responsible for the major part of our consumption?

Mr. RYAN. I view this case from the State perspective. From what we have seen of this scheme, and what the witness this morning testified to, to us it is the same gasoline as it is to the seven sisters. They sell their gasoline, whether through the normal distribution chains or through the bootleggers. From what we have seen, we have not seen any participation by the seven major companies in this bootlegging.

From what we can see, if profit is the motive, there is no profit motive for the seven major companies to engage in this. We have seen companies that are far larger than those thus far charged that are under investigation at this time.

Mr. GUARINI. In regard to the narcotics hearings, we were informed by one U.S. attorney general who said that he is closing files that he is not following through on which involve narcotics traffickers and dealers, because he doesn't have enough personnel and he doesn't have enough support and resources to be able to even pursue the files that are legitimate files.

Do you have any situation like that as a result of the Gramm-Rudman Act or the budget cuts that have impaired your operations?

Mr. RYAN. I think you are asking the wrong person. As I said, I am from the State.

Mr. GUARINI. Mr. Richard.

Mr. RICHARD. I am not aware, Congressman, of the Department of Justice or any Federal investigative or regulatory agency closing a case containing viable leads merely because——

Mr. GUARINI. I assure you this is the testimony of Mr. Grelish.

Mr. RICHARD. I am not quarreling with his testimony. I am talking about in the context of the oil and gasoline cases.

Mr. GUARINI. Where lies the fault? What has to be done with regard to tightening up our laws? We don't want to get the problem after it happens. We want to be able to avoid having the problem happen in the first instance.

What does this Government and this committee have to do in order to straighten out this problem of excise tax fraud on gasoline?

Mr. RICHARD. If I may answer that in parts, one, I just want to complete my thought, if I may, with respect to the resource question. If, as the chairman suggests, this is a systemic problem—that is to say, that we are in reality being confronted with 50, 60 different independent conspiracies operating throughout this country—we may very well have a very serious resource problem that we will have to address.

Mr. GUARINI. Is the problem getting worse, or have you got it under control?

Mr. RICHARD. I would not be presumptious enough to say that we have it under control because we are still trying to find out the real dimensions of this problem.

Mr. GUARINI. We have no idea how pervasive or how broad it is; is that right?

Mr. RICHARD. We know this much, I believe: Based on the experience in New York, that these kinds of schemes that we are encountering in the New York area can be run in any—in most locations around the country. Whether they are, in fact, being run to the same extent and with the same dimensions and scope, I cannot say with any certainty at this time.

Mr. GUARINI. Then you have no idea as to the true dimension of the problem?

Mr. RICHARD. The ultimate dimensions, I would suggest to you at this point, is still somewhat speculative. However, I can tell you, based on our experience, that you have vulnerability out there. You have a system in place that lends itself to this kind of abuse. The extent and magnitude of the abuse, I cannot say with any great certainty.

Mr. GUARINI. I imagine the first thing we have to do is identify the problem and find the solution. You are telling me that we are just beginning to identify the problem, so that you don't know whether the resources are adequate or inadequate; that you are in the process of trying to find our way through the maze that has developed in the real world?

Mr. **Richard**. We have identified the profile of the abuse. The extent to which the abuse is occurring, I submit we do not know with absolute certainty. However, I do think obviously all the regulatory agencies must gear up to determine exactly the extent of the abuse they are suffering.

Mr. **Guarini**. From a law enforcement officer, where lies the fault? Is it the U.S. Customs that is not monitoring ships coming in, or is it the fact that the IRS is not monitoring its 637 exemptions properly?

There have to be recommendations that you can make so that we can avoid having some of these law enforcement problems.

Mr. **Richard**. Based on my 19 years of experience with the Department of Justice, I can tell you that a system for revenue collection as complex as this is ripe for abuse. I do not have the expertise to suggest to you fixes that would be acceptable given all the concerns involved. But I can tell you that the current system invites abuse, and the complexity of the system for the collection I would suggest is a principal contributor to this kind of abuse.

Mr. **Guarini**. Those are conclusions. I am asking you for recommendations.

How can we avoid this? Should we tax at the refinery level?

Mr. **Richard**. I would suggest, as I indicated, that that be given serious considerations, sir.

Mr. **Guarini**. What other serious considerations should we give?

Mr. **Richard**. There has to be, I suggest, closer scrutiny of these applications for tax-exempt transactions. There has to be a screening mechanism. It has been suggested some bonding might be appropriate. But it would be presumptious of me to say that I am recommending it.

Mr. **Guarini**. We need your advice. Should we do something with regard to Customs? There is a tremendous amount of oil coming in from overseas. We have no idea as to the logging-in of much of this oil.

Is there any recommendation you would have with regard to how Customs treats the problem, because that allows the bootlegging, I imagine?

Mr. **Richard**. I am not sure that we can make specific recommendations or even observations with respect to the process of how it is handled by Customs.

Mr. **Guarini**. Thank you.

Chairman **Pickle**. Mr. Anthony.

Mr. **Anthony**. Thank you, Mr. Chairman.

I would like to make a request of Mr. Daniels and Mr. Richard to help the committee assimilate some data so that we can try to answer some of the questions that Mr. Guarini raised. Yet you say you can't answer, because we don't have a data base to make the statistical analysis.

Could you, give us a list of past and pending cases? You could show us your past track record, those cases that you investigated, turned over to the strike force or to the Justice Department, and what was the outcome. I would like to know what the punishment was, what the statutory authority was that you used for the indictment. Then we can judge the effectiveness of the various statutory provisions.

From the prosecutor's standpoint, Mr. Richard, could you give us the data of past and pending cases? Could you break that down into dollar amounts so that we could have some objective way to try to formulate what the magnitude of this problem is.

Mr. RICHARD. I think we can provide that.

[The following was subsequently received:]

FOR THE RECORD

U.S. Department of Justice
Federal Bureau of Investigation

Washington, D.C. 20535

August 29, 1986

Honorable J. J. Pickle
Chairman, Subcommittee on Oversight
Committee on Ways and Means
House of Representatives
Washington, D. C. 20515

Dear Mr. Chairman:

I would like to take this opportunity to respond to a question posed to me by Congressman Anthony during my testimony before your Subcommittee Hearings on the Compliance of Federal Excise Tax on the Sale of Gasoline on 7/15/86. Mr. Anthony requested that the FBI identify investigations, prosecutions, predicate offenses charged, and dispositions relating to the evasion of Federal excise tax on the sale of gasoline.

Let me preface my response by stating that primary responsibility for enforcing Federal excise tax law lies with the Internal Revenue Service (IRS). Involvement of the FBI in investigations relating to this crime problem have been incidental to the national priority within the FBI of attacking the influence of traditional and non-traditional organized crime within legitimate industries. Information received by the FBI from sources or the general public alleging excise tax fraud are appropriately referred to the IRS or state and local tax enforcement authorities. Since the Long Island Organized Crime Task Force (LIOCTF) exposed the scope of the gasoline tax fraud problem and the extent of organized criminal involvement in perpetuating this activity, the FBI has alerted its field offices nationwide to task informants and law enforcement sources to develop the intelligence necessary to predicate investigations in the areas of White Collar Crime or Organized Crime.

Attached is a listing of investigations handled by the LIOCTF which have resulted in at least partial legal adjudication.

Additional investigations are being conducted by the Task Force and the FBI has instituted criminal investigations in other areas which may impact on the excise tax collection problem, but since these matters have not reached the prosecutive stages, I am unable to identify these at this time.

If I can be of any further assistance, please do not hesitate to contact my office.

Sincerely,

Anthony E. Daniels

Anthony E. Daniels
Deputy Assistant Director
Criminal Investigative Division

Enclosure

The following individuals are defendants in criminal proceedings as a result of the investigations conducted by the LIOCTF.

DEFENDANT	INDICTMENT	CONVICTION	SENTENCE
Lawrence Iorizzo (Operator, Vantage Petroleum)	Interstate Transportation of Stolen Property (ITSP), Wire Fraud (WF),	ITSP, WF	5 yrs.; $1.7 million restitution
	Mail Fraud (MF)	MF	5 yrs. probation
Michael Franzese (Colombo LCN member)	Racketeering Influenced and Corrupt Organizations (RICO) Predicate Acts: MF, Fraud by Wire (FBW), Conspiracy-Tax Evasion (Consp.)	RICO	10 years; $14.7 million restitution
Louis Fenza (Operator, Down To Earth Management Corp.)	RICO-MF, FBW, Consp.-	RICO	5 yrs. 5 yrs. probation
	Embezzlement of Union Funds		$500 fine
	New York (NY) State: Grand Larceny; Offering a False Instrument	same	3 yrs. $300 fine
Frank Castagnaro (Operator, 714 East Forth Street Corp.)	RICO-FBW; Consp. 2 cts)	RICO	8 yrs., 5 yrs. probation, $5,000 fine
	NY State: Grand Larceny; Offering a False Instrument	same	14 yrs., $14,000 fine
Frank Cestaro	RICO-MF (2cts.). Consp.	RICO	5 yrs., 5 yrs. probation, $5,000 fine
Allan Stuart (Accountant, Power Test Petroleum)	MF	MF	3 yrs. probation
Charles Forthmuller (Operator Amtec Petroleum)	Conspiracy	MF	3 yrs. probation
	Conspiracy	Conspiracy	18 months $10,000 fine

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DEFENDANT	INDICTMENT	CONVICTION	SENTENCE
Bernard Short (Operator, C.P.H. Petroleum)	NY State: Offering a False Instrument	Pled guilty	awaiting sentence
Martin Diaz (Operator, Dand I Supply Corp.)	NY State: Offering a False Instrument	same	5 months, 5 yrs. probation, $112,000 restitution
Sheldon Levine (Operator, No Brand Petroleum)	Obstruction of Justice (OOJ), Conspiracy NY State: Grand Larceny, Falsifying Business Records, Criminal Solicitation, Conspiracy.		
Oscar Porcelli (Operator, Ditmas Oil)	Mail Fraud		
James Garcia Sorrentino (Operator, Save-On Petroleum)	Mail Fraud		
Pedro Paredes	Mail Fraud		
Ahmet Bahcivan (Operator, KAV Petroleum)	NY State: Filing a False Motor Fuel Return		
David Bogatin (Operator, Lesez Petroleum)	NY State: Offering a False Instrument		
Joseph Skolnick (Operator, Capitol Ent.)	Offering a False Instrument		
Michael Markovitz (Operator, Gas Stop, Inc.)	Offering a False Instrument		

DEFENDANT	INDICTMENT	CONVICTION	SENTENCE
Joseph Galizia (Genovese LCN member)	NY State: Grand Larceny, Falsifying Business Records, Criminal Solicitation (CS), Conspiracy-Excise Tax Evasion (CETE)		
Gerald Friedberg (Operator, Lewis Petro Chemical Corp., Seaplane Shuttle Corp.)	Grand Larceny, Falsifying Business Records (FBR), CS, CETE		
Igor Roizman (Operator, Grunstar Petroleum)	Grand Larceny, FBR, CS, CETE		
Igor Portsky (Co-operator, Greenstar Petroleum)	Grand Larceny, FBR, CS, CETE		
Nicky Dozortcev	Grand Larceny, FBR, CS, CETE		
Gerald Teisch	Grand Larceny, FBR, CS, CETE		
Purgot Ozen (O.B. Ent.)	Connecticut State: Larceny		
Muhammet Ozen (C.B. Ent.)	Larceny		
Michael Morgano (O.B. Ent.)	Larceny		
Ismet Kipchik (O.B. Ent.)	Larceny		
Louis Padurano (Operator, Novak Petroleum)	NY State: Grand Larceny	Grand Larceny	6 mo., 5 yrs. probation, $268,112 restitution
Edward Cohen (Operator, EEC Petroleum, Amber Petroleum)	NY State: Grand Larceny, Scheme to Defraud	Grand Larceny Scheme to Defraud	6 mo., $50,000 restitution

Mr. **Anthony**. It is not in your testimony. Your testimony is more general in that regard. So, if you could, in a letter directly addressed to the chairman, specify past and current case histories; also if you could, as long as we keep the record open, provide cases that you have under current investigation, when they are made public. If you could add them to your data base, I think it would help us.

Mr. Ryan, how do we go about getting the same thing out of the States?

Mr. **Ryan**. We would be glad to contribute for the State of New York.

Mr. **Anthony**. If you could do that from the State of New York or past and pending cases, and the record will remain open for future cases. Maybe you could make suggestions as to how we could go about getting similar information from the States read out by the chairman as those that seem to be problem States.

I have a broader question. Is there anything unusual in the amount of tax that is imposed or any other demographic characteristic there that indicates why these problem States are more targets than other States?

Mr. **Ryan**. The State of New York at present has an excise tax similar to the Federal excise tax—8 cents a gallon. In addition to the State excise tax, we also have a sales tax which is—ranges up to 8¼ percent of the sales price. So, figuring a sales price of $1, which it was for much of this time period, New York was imposing approximately 16 cents per gallon; the Federal Government imposing approximately 9 cents per gallon.

For example, in the State of New Jersey, which has a similar excise tax, it has no sales tax on gasoline; and while Jersey has a problem, it seems to be somewhat less than that of New York.

Mr. **Anthony**. Let me stop you there.

Do you see any correlation in the amount of taxes that are imposed totally by the Federal and State Governments that would target those particular areas for criminal activity?

Mr. **Ryan**. I would speculate that there is a correlation, but there is also the possibility that where the tax liability is larger and there is larger evasion, it is easier to detect. Where those that are stealing the tax have more to steal, there are times that they can deliver the product to a better keeper than the competitors. At times, it will be more readily apparent because you will notice a slight drop at the pump.

In New York, the problem originated in high population counties that were also highly mobile, the suburbs of New York City where the population is still relatively large, but most people rely on private cars; and where there were a lot of gas stations out there in competition for the motoring public's dollar. And that is where the problem first surfaced to the point where it became apparent to us there was something to follow up on.

Mr. **Anthony**. Mr. Bernstein, you are in the strike force?

Mr. **Bernstein**. That is correct.

Mr. **Anthony**. Are you actually a trial lawyer and present evidence in court?

Mr. **Bernstein**. I am.

Mr. ANTHONY. There is a bill pending in the House, 1605, that would make gasoline bootlegging a RICO crime.

Can you give us an opinion as to whether or not that would be beneficial or nonbeneficial? If you are not prepared to answer today, if you could maybe take a look at 1605, Mr. Richard, in consultation with Mr. Bernstein, and give us some opinion as to whether or not this would be beneficial.

Form 720, have you found form 720 helpful or nonhelpful in your investigation and prosecution of cases? Form 720, is the quarterly tax report.

Mr. BERNSTEIN. Very little use, I understand.

Mr. ANTHONY. Very little use.

If you would, take a look at form 720, inasmuch as it is a tax reporting document. Look in terms of how that particular document could be strengthened to gain additional information so that it would give you better leads for investigation or the ability to prosecute in the event there were evasion of taxes.

The reason I ask that, in consultation with the undisclosed witness a while ago, his information to us is that the average people consider form 720 to be a joke. If it is considered to be a joke, it appears to us we should look at it to strengthen it so the joke turns back on the perpetrators of crime rather than on the people abiding by the law.

I yield back.

Chairman PICKLE. Gentlemen, we thank you. Your testimony has been helpful to us.

I am concerned, again, that we are not pursuing this as aggressively as we should. It seems to me we need a lot more information about this problem than we have been able to obtain as a subcommittee, or than the public understands.

Our committee has been asking for information from Treasury and from the IRS for the past year, and we are told, "We are looking into it; it is a problem, and we have it under control."

It seems to me it is far from being under control. We don't know how much gasoline is being transported within our boundaries or imported. These so-called nighttime operations in New York are an open invitation for bootlegging, for racketeering, and for wholesale fraud and corruption. That has led to shooting even by the mob families, which you admit is going on.

It seems to me this is an enormous problem, and when you say it is an enormous problem and the losses are enormous we are led to believe that the losses may be in the neighborhood of a billion dollars a year or more. So, it seems to me like this problem of gasoline tax evasion and gasoline bootlegging is as big a problem as the whiskey bootlegging days of Al Capone. If that is so, then we must together do something about it.

We are not asking you specifically for reforms of legislation or other help, but whatever it takes I think we should address it. So we hope you give us any additional information, and we are going to ask you questions in writing that we haven't been able to ask today because of time. We hope you will respond to them as quickly as possible.

Thank you very much for your testimony.

[The following was subsequently received:]

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July 22, 1986

RECEIVED
SEP 9 1986
Ways and Means
Subcommittee on Oversight

The Honorable Edwin Meese III
Attorney General
U.S. Department of Justice
10th and Constitution Avenue, N.W.
Room 5111
Washington, D.C. 20530

Dear Mr. Attorney General:

The Subcommittee on Oversight of the Committee on Ways and Means held a hearing on July 15, 1986 to examine compliance with the federal excise tax on the sale of gasoline, and related enforcement efforts. Mark Richard, Deputy Assistant Attorney General, Criminal Division and Anthony E. Daniels, Deputy Assistant Director, Criminal Investigative Division, Federal Bureau of Investigation, testified at the hearing.

Enclosed are additional questions for the Department of Justice. The answers to these questions will provide a more complete record for the hearing. I request that you please expedite the response to the enclosed questions, as the hearing record will be going to the printer on September 12, 1986.

In addition, would you please provide the Subcommittee with a list of past and pending gasoline excise tax evasion cases handled by the Department of Justice. Please include for each case the statutory basis for the indictment and the outcome of the case, including sentences rendered and fines and penalties imposed.

If you have any questions, please contact Beth Kuntz, Staff Director, at 225-5522.

Sincerely,

J. J. Pickle, Chairman
Subcommittee on Oversight

JJP/tmk

Enclosure

QUESTIONS FOR THE DEPARTMENT OF JUSTICE

1. How did you become aware of schemes to evade gasoline excise taxes?

   If it were not for the Long Island Organized Crime Task Force, would the Department have uncovered this evasion?

   Without organized crime involvement, would the Department give gasoline excise tax evasion a high priority?

2. How much federal revenues loss from gasoline excise tax evasion has been identified, to date, in closed or pending investigations/prosecutions?

   a. Do those firms that are evading gasoline excise taxes evade payment of federal income taxes as well? What is the extent of this income tax evasion and how much revenue loss is associated with it?

3. What federal statutes are involved in these evasion cases (e.g., mail, wire and bankruptcy fraud, conspiracy, obstruction of justice, tax evasion, RICO)?

   a. What specific fines and penalties can be imposed under each of these statutes?

   b. What statute potentially provides the greatest deterrent?

4. Specifically, what role do the criminal tax provisions of the Internal Revenue Code play in federal prosecution of these evasion cases?

   a. Are these provisions adequate? Should they be strengthened, and if so, to what extent?

5. What type of enforcement efforts are there with other federal agencies, including IRS, Customs, etc., in the New York metropolitan area? Outside New York?

   a. Specifically, what additional enforcement tools are needed to address the evasion problem?

   b. What coordination efforts exist with state and local authorities?

6. Are the current tax reporting requirements--Form 720--helpful to the Department's investigations and prosecutions of evasion schemes?

7. Is the IRS registration system (i.e., Form 637) a good compliance tool or does it actually aid and abet evasion schemes? What changes are needed?

   a. Would a federal bonding requirement solve the evasion problem?

8. Is there any Federal information source currently available that demonstrates the full scope of payment of federal gasoline excise taxes or of noncompliance?

   Are you dependent on state data? Is there uniform state data?

   How can better data be obtained and used? What additional information would be helpful?

9. Did one or more attorneys working for the Long Island Organized Crime Task Force leave the employment of the Government to work for a company or individual under investigation? If so, why does this not reflect improper or unethical conduct? Is such a situation commonplace?

   Have there been leaks of information from the Task Force's investigations? If so, have these leaks been serious? Are they still occurring?

10. What experience is the Department having with regard to the sale to foreign and domestic airlines of gasoline from bonded facilities in Southern Florida?

    a. Is there a significant evasion scheme conerning such sales?

    b. Are any major oil companies under investigation concerning this type of scheme?

11. Are there known compliance and enforcement problem areas with regard to the excise taxes on diesel and other motor fuels? With regard to other excise taxes, including those on tobacco products and alcoholic beverages?

U.S. Department of Justice

Office of Legislative and Intergovernmental Affairs

Office of the Assistant Attorney General

Washington, D.C. 20530

17 [illegible] 1986

Honorable J. J. Pickle
Chairman, Subcommittee on
Oversight
Committee on Ways and Means
House of Representatives
Washington, D. C. 20515

Dear Mr. Chairman:

This letter is in response to your request dated July 22, 1986, for answers to questions submitted on the subject of compliance with the federal excise tax on the sale of gasoline.

1. Initial Information Concerning Excise Tax Evasion

The Organized Crime Strike Force for the Eastern District of New York first learned of schemes to evade federal gasoline excise taxes in 1982 when separate investigations by the Federal Bureau of Investigation (FBI) and Internal Revenue Service (IRS) began to disclose massive tax evasion by independent gasoline distributors on Long Island. It is interesting to note that neither the FBI nor the IRS investigations originally began as an inquiry into gasoline excise tax evasion.

The FBI's effort began in 1979 as an investigation into potential violations of Environmental Protection Agency regulations when several large oil and gasoline spills occurred on the Long Island coast. Information developed through confidential sources in the course of that investigation eventually corroborated allegations in local newspapers that federal and state gasoline taxes were not being paid by Long Island gasoline distributors. Utilizing information from knowledgeable people within the Long Island gasoline industry, agents began to identify the corporations responsible for excise tax theft and their ties to organized crime. Information of large-scale evasion of excise tax was also developed as a result of numerous complaints about the quality of the gasoline that consumers purchased at unbranded gasoline stations on Long Island. By the summer of 1981, confidential information developed by the FBI indicated that millions of dollars worth of untaxed gasoline was passing through New York City harbor. The focus of the investigations shifted accordingly in an effort to halt the tax evasion.

The IRS examination of excise tax evasion centered on an individual who owned a number of retail gasoline stations on Long Island. As the investigation progressed, insiders in the local gasoline industry provided IRS agents with a first-hand view of large-scale excise tax evasion.

By 1982 it become apparent that the FBI and IRS investigations overlapped. In order to avoid a duplication of effort and to enhance the investigations by providing a free flow of information, the investigations were brought to the Organized Crime Strike Force for the Eastern District of New York.

The Long Island Organized Crime Task Force

The Long Island Organized Crime Task Force was formed in November 1982 to coordinate the efforts of the aforementioned investigations by federal and local agencies. The task force is presently comprised of agents and prosecutors from the offices of the Organized Crime Strike Force for the Eastern District of New York, the United States Attorney for the Eastern District of New York, the Tax Division of the United States Department of Justice, the New York State Attorney General, the District Attorneys of Nassau and Suffolk Counties, FBI, IRS, the New York State Department of Taxation and Finance, the Police Departments of Nassau and Suffolk, and the New Jersey State Attorney General. Since the inception of the task force, the Organized Crime Strike Force for the Eastern District of New York has been the principal coordinating agency.

The task force has provided investigators and prosecutors with a unique opportunity to share resources and information, and has resulted in a more efficient and powerful prosecution of gasoline excise tax violators. It is likely, however, that even without the formation of the task force the federal government would have uncovered excise tax evasion in the New York metropolitan area. The great value of the task force has been in the area of coordinating the work of numerous prosecutors and agents at the investigative stage.

Priority of Excise Tax Evasion Prosecution

Very early in our investigation it was discovered that traditional organized crime families, including the Lucchese, Genovese, and Colombo crime families in New York, played a large role in excise tax evasion. These criminal organizations settied disputes and solidified the bootlegger's place in the market place in return for a share of the profits. The primary goal of the Organized Crime Strike Force is to rid the gasoline industry of this organized crime presence. The Organized Crime Section will continue to investigate and prosecute excise tax schemes involving significant organized crime elements.

Excise tax schemes are not limited to organized crime elements, of course. Every businessman in the industry of distributing and selling gasoline has the opportunity to cheat on excise taxes if he elects to do so. No precise figures for the total amount of the theft exist, but the Subcommittee is aware that estimates have reached the hundreds of millions of dollars. The theft of excise tax revenue is thus an area which concerns law enforcement at every level of government. The Department acknowledges that excise tax evasion is a problem deserving continued federal attention regardless of the participation of organized crime, and recognizes its role in halting these thefts.

2. Federal Revenue Loss

The Long Island Organized Crime Task Force has identified approximately $80 million in federal excise tax revenue lost through gasoline bootlegging in the New York metropolitan area. This is broken down as follows: Approximately $19 million in closed cases, approximately $10 million in pending cases, and approximately $51 million in pending investigations.

It should be emphasized that these figures are conservative and do not include:

1. Thefts yet to be detected;
2. Thefts that have been detected but where the amount stolen and the identity of the tax evader have not been determined;
3. Thefts that have been discovered but where the tax loss cannot be computed because the perpetrator has already been charged or convicted, at which point precious prosecutorial resources have been diverted to related investigations.

Income Tax Evasion

There is no known pattern of income tax evasion associated with excise tax evasion. Simply put, some excise tax evaders pay their income tax and some do not. At this point, no figures have been accumulated to show the extent of income tax evasion on the part of gasoline firms. Some income tax prosecutions have occurred as a result of the excise tax investigation, and other cases are now under investigation. These cases usually arise, however, as incidental by-products of the main gasoline excise tax investigation and tend to be small in comparison to the excise tax evasion schemes.

3. Federal Statutes

The following is a listing of those federal statutes which have been used, or are anticipated to be used in excise tax evasion cases:

A. RICO Statute, 18 U.S.C. §1962: The racketeering statute provides for a twenty-year maximum period of incarceration and/or a maximum fine of $25,000. The statute also contains extensive provisions providing for the forfeiture of the profit of the criminal enterprise. The power of the RICO statute and its tough sentence provisions has been well publicized. As a result, it is not surprising that the use of the RICO statute by federal prosecutors is feared by excise tax evaders. The RICO statute thus represents the greatest deterrent to organized excise tax evaders.

B. Obstruction of Justice, 18 U.S.C. §1503: The statute provides for a maximum period of incarceration of five years and/or a maximum fine of $5,000. This statute has proved useful when the excise tax evader has purposefully secreted or destroyed records subpoenaed by a federal grand jury.

C. Conspiracy, 18 U.S.C. §371: The statute provides for a five year maximum period of incarceration and/or a maximum fine of $10,000. The conspiracy statute has been used to allege overall tax evasion schemes.

D. Mail Fraud, 18 U.S.C. §1341: The statute provides for a five year maximum period of incarceration and/or a maximum fine of $1,000.

It should be noted that upon conviction of a felony committed after December 31, 1984, an individual defendant may be fined a maximum of $250,000 and a corporate defendant may be fined a maximum of $500,000. (18 U.S.C. §3623).

E. Attempt to Evade or Defeat Tax, 26 U.S.C. §7201: The tax evasion statute provides for a five-year maximum period of incarceration and/or a maximum fine of $100,000. The costs of prosecution may also be included as part of the sentence.

F. Willful Failure to Collect or Pay Over Tax, 26 U.S.C. §7202: The statute provides for a maximum period of incarceration of five years and/or a maximum fine of $10,000. The costs of the prosecution may also be included as part of the sentence.

G. Fraud and False Statements, Aid or Assistance, 26 U.S.C. §7206(2): The statute provides for a three-year maximum period of incarceration. An individual defendant may be fined a maximum of $100,000. A corporate defendant may be fined a maximum of $500,000. The costs of prosecution may be made a part of the sentence.

H. Failure to Register, or False Statements by Manufacturers or Producers of Gasoline or Lubricating Oil, 26 U.S.C. §7232: The statute provides for a maximum period of incarceration of five years and/or a maximum fine of $5,000. The costs of prosecution may be made a part of the sentence. While research has revealed no reported prior use of this statute, it is anticipated that the statute can be effectively used in those cases where a tax evader fraudulently represents that he possesses a Registration for Tax Free Transactions (IRS Form 637).

I. Reports on Domestic Coins and Currency Transactions, 31 U.S.C. §5313, 31 U.S.C. §5322: The statute provides for a maximum period of incarceration of one year and/or a maximum fine of $1,000 for the willful failure to file Currency Transaction Reports (Form 4789) when conducting cash banking transactions in excess of $10,000. If the willful failure to file Currency Transaction Reports is part of a pattern of illegal activity involving more than $100,000 in a twelve-month period, the statute provides for an increased sentence of a maximum of five years' imprisonment and/or a maximum fine of $500,000. Investigation has revealed several schemes by excise tax evaders to launder their illegal profits by conducting large cash transactions with banking institutions. It is anticipated that the provisions of Title 31 will prove an effective way of attacking these laundering schemes.

4. The Role of the Criminal Tax Provisions

The criminal tax provisions of Title 26 play a central role in the war against excise tax evasion. Specifically, the provisions relating to tax evasion (26 U.S.C. §7201), failure to collect and pay over tax (26 U.S.C. §7202), and false statements (26 U.S.C. §7206(2)) have constituted the primary charges in several indictments and are expected to be the basis of several other cases now under investigation. With the exception of those cases involving organized crime figures, such as Michael Franzese, who was mentioned in testimony before the Subcommittee, and for whom RICO prosecution was appropriate, the penalties of the criminal tax statutes, insofar as they provide for three to five years maximum period of incarceration, are appropriate. It is, of course, always the option of a sentencing judge to impose consecutive sentences for criminal activity occurring in several financial quarters in the case of a serious offender.

5. Coordination of Enforcement Efforts

The Organized Crime Section has, from the outset of its excise tax investigations, experienced a close working relationship with the federal agencies involved in excise tax enforcement. The FBI and IRS have, from the time the investigations were first undertaken by the Organized Crime Section, provided the field investigators and tax expertise required by Strike Force attorneys conducting investigations. Further, the Organized Crime Section has at its disposal, within its own offices, representatives from various other federal, state and local law enforcement agencies. In the Eastern District of New York, for example, there are representatives from Customs, the Department of Labor, the New York State Police, and the New York City Police Department. These agencies have provided valuable information and back-up investigation when required. Thus, information supplied by Customs agents was used recently in the investigation of suspected flight by a defendant awaiting trial.

When it has become apparent that the activities of gasoline excise tax evaders have crossed state lines the cooperation among federal law enforcement agencies has crossed state lines as well. In the Franzese case, for example, prosecutors and investigators in New York worked closely with prosecutors in the Southern District of Florida.

Coordination with State and Local Authorities

With the formation of the Long Island Organized Crime Task Force in November 1982, full cooperation between the federal, state and local law enforcement agencies in the New York metropolitan area was attained. As a result, FBI and IRS investigators work hand in hand with state and local investigators, utilizing the same physical resources and sharing sources of information. Federal prosecutors regularly work with cross-designated state and local prosecutors and reciprocally assist state and local prosecutors in bringing cases against excise tax evaders in their own jurisdictions. Federal, state and local law agencies have presented a united front against excise tax evasion in the Long Island area.

The effort to fully coordinate federal, state, and local prosecutions is continuing and, with the recent addition of the Office of the Attorney General of the State of New Jersey to the Long Island Organized Crime Task Force, the Department has a new ability to reach tax evaders across state lines.

Additional Enforcement Tools

The most important tools needed to address the evasion problem are changes in the registration and reporting systems which will make excise tax evasion more difficult to accomplish and easier to uncover once it has occurred. The reporting and registration systems are discussed in the answers to questions 6 and 7, respectively.

6. The Quarterly Federal Excise Tax Return

Throughout our examination of excise tax evasion, investigators have universally criticized the Quarterly Federal Excise Tax Return (IRS Form 720) as a poor investigative tool.

Some of the chief difficulties encountered by excise tax investigators are (1) determining the actual amount of gasoline purchased by tax evading corporations, (2) following the paper trail as gasoline changes hands in order to determine the ultimate recipient of the gasoline, and (3) distinguishing a set of records reflecting real gasoline transactions from fraudulent sets of records created by the excise tax evader in order to deceive investigators. The Quarterly Excise Tax Return does not help investigators overcome these difficulties.

The current federal reporting procedure requires only that the reporter state the total excise tax liability incurred on the sale of gasoline, the total excise tax liability incurred on the sale of diesel and motor fuel, and the amount of the liability which falls into each of the six fifteen day periods making up the quarter. As now drafted, the federal excise tax return allows a gasoline producer to list all taxable transactions in bulk. Thus the return provides no means by which the activities of the excise tax evader can be checked. There is no way for an investigator to use this form to help trace gasoline from honest gasoline distributors to gasoline tax evaders, or to determine whether corporate documents represent real or fraudulent gasoline transactions. When a tax thief files his return he is safe in the knowledge that he has given the Government little information which can be used to catch him.

As a result, federal investigators often must rely on state tax forms, such as New York State Form MT 104, which require the reporter to attach, as addenda, schedules listing the source of gasoline received, to whom it was sold, the total amount of tax exempt gasoline sold, and the total amount of taxable gasoline sold. Utilizing the New York State tax return, investigators have a basis for cross-checking the transactions between various gasoline companies looking for discrepancies which may indicate tax evasion.

As now drafted, the value of the Quarterly Federal Excise Tax Return (IRS Form 720) lies only in providing a basis for an additional charge of fraud and false statement, 26 U.S.C. §7206(2), once the tax evader has already been caught.

7. The Internal Revenue Service Registration System

The experience of federal investigators indicates that the registration system now in place to account for those gasoline producers making tax free sales is not an effective compliance tool.

The reasons for this revolve around the lack of effective investigation of applicants prior to the issuance of Registration for Tax Free Transactions (IRS Form 637). The history of gasoline excise tax evasion is replete with examples of gasoline bootleggers who are denied registration in one jurisdiction only to obtain it under a new corporate name in another. The Department has also discovered cases of registrants supplying false employer identification numbers on registration forms. It is common to uncover the use of strawman applicants to obtain registration certificates for "shell" corporations with addresses that are only mail drops. As explained to the Subcommittee, these "shell" corporations are used to hide the theft of excise tax on millions of gallons of gasoline. Investigation has even revealed the existence of individuals who obtain registration certificates for tax evaders for a fee.

Three changes are suggested which would substantially improve the registration system. The first two should be accomplished easily; the third is more difficult.

1. Registration applications should be computerized so that each region can have immediate access to a central nationwide listing of applicants. This list should be accessible upon furnishing the name of the corporate applicant or personal applicant as well as by number. At the present time each region must be telephoned individually, and a physical check made to determine whether prior applications have been made and whether they were granted or denied. It is hoped that this type of computer access would reduce the number of tax evaders who simply reapply in different regions until they receive favorable consideration on their applications.

2. Firms holding valid registration certificates should be required to reapply for registration upon the sale of the corporation. This would prevent the transfer of certificates to bootleggers who purchase unprofitable corporations holding registration certificates, and then use the newly acquired corporation to "daisy chain" tax evasion schemes.

3. An effort should also be made to determine the identities of the real parties-in-interest behind corporate applicants prior to allowing the corporation to register for tax free transactions. Such efforts, while difficult to accomplish, could reduce the ability of tax evaders to acquire tax exempt shell corporations through the use of strawman applicants or certificate brokers.

Federal Bonding

The imposition of a federal bonding requirement has been suggested, as an effective device for the reduction of excise tax evasion, by federal, state and local law enforcement authorities.

The primary advantage to be gained from a bonding requirement is that the government would, upon discovery of tax theft, have recourse to the bond. It is also hoped that bonding would make registration more difficult for the bootlegger and provide an additional vehicle for tracing the tax evader should a tax theft occur.

While a federal bonding requirement would certainly be one part of a solution to the tax evasion problem, it would not be, by itself, a total solution. The bonding requirement alone does not ensure that registration for tax free sales is limited to those firms engaged in legitimate tax free transactions, nor, given the current format of the Quarterly Federal Excise Tax Return, does it ensure proper reporting of taxable gasoline transactions.

8. Data on Compliance and Non-Compliance

There is no federal source which can be consulted to provide accurate information on the extent of compliance and evasion of federal gasoline excise taxes. The information utilized during the course of federal investigations is derived from several sources. It is based, in part, upon the allegations of individuals who were formerly gasoline bootleggers and who are now cooperating with the government's investigation. Other information is derived by investigation on a case-by-case basis as investigators verify the existence of tax losses through examination of corporate records and tax returns. Needless to say, the Department's understanding of the overall picture of tax compliance and evasion is incomplete. This is true even for limited geographical areas such as the New York metropolitan area.

State data is similarly incomplete. New York State data, for example, generally is derived from state excise tax returns. As such, the totals reflect only the gasoline and taxes included on the returns. The totals do not include gasoline which passed into New York or was sold in New York as bootleg gasoline.

Based upon a comparison of excise tax revenues over nine month periods, New York State has attempted to estimate the extent of its revenue loss prior to the change in the state tax law on June 1, 1985. New York officials admit, however, that it is impossible for them to establish how much tax evasion has occurred in the past.

Additional Information Needed

The experience of federal prosecutors has demonstrated that the information which would be most useful in combatting gasoline excise tax evasion is accurate information as to the amount and source of gasoline entering the local prosecutorial jurisdiction. Prosecutors could then measure the success of their efforts by comparing volume of gasoline sold against revenues received, and trace from entry into the jurisdiction the gasoline that was sold without proper payment of excise taxes.

9. Departing Attorneys

No attorney who took part in the work of the Long Island Organized Crime Task Force has left government service for employment by any individual or company charged with, or under investigation for, excise tax evasion. Two former federal prosecutors who were assigned to the Brooklyn Strike Force left government service in May 1982, six months prior to the formation of the Long Island Organized Crime Task Force, and have since represented defendants indicted by the task force. No conflict of interest or compromise of the task force's prosecutions has occurred.

Leaks

No leaks of information from the task force's investigation have occurred or are suspected of having occurred.

10. Sale of Gasoline to Foreign and Domestic Airlines

The Department has not uncovered and has no information relating to an evasion scheme concerning the sale of gasoline from bonded facilities in Southern Florida to foreign and domestic airlines.

11. Excise Taxes on Diesel and Other Motor Fuel

The Department has learned, based upon FBI source information, that schemes involving the sale of diesel fuel for motor vehicles under the guise of home heating fuel in order to evade the payment of excise taxes may be occurring in the New York metropolitan area. These allegations have not been a major focus of Department investigations and remain unverified.

12. List of Gasoline Tax Evasion Cases

DEFENDANT	INDICTMENT	CONVICTION	SENTENCE
Lawrence Iorizzo (Operator, Vantage Petroleum)	Interstate Transportation of Stolen Property (ITSP), Wire Fraud (WF)	ITSP, WF	5 yrs.; $1.7 million restitution
	Mail Fraud (MF)	MF	5 yrs. probation
Michael Franzese (Colombo LCN member)	Racketeering Influenced and Corrupt Organizations (RICO) Predicate Acts: MF, Fraud by Wire (FBW), Conspiracy-Tax Evasion (Consp.)	RICO	10 yrs.; $14.7 million restitution
Louis Fenza (Operator, Down To Earth Management Corp.)	RICO-MF, FBW, Consp.	RICO	5 yrs. 5 yrs. probation
	Embezzlement of Union Funds		$500 fine
Frank Castagnaro (Operator, 714 East Fourth Street Corp.)	RICO-FBW; Consp. (2 cts.)	RICO	8 yrs., 5 yrs. probation, $5,000 fine
Frank Cestaro	RICO-MF (2 cts.) Consp.	RICO	5 yrs., 5 yrs. probation, $5,000 fine
Allan Stuart (Accountant, Power Test Petroleum)	Mail Fraud	MF	3 yrs. probation
Charles Forthmuller (Operator Amtec Petroleum)	Conspiracy	MF	3 yrs. probation
	Conspiracy	Conspiracy	18 months $10,000 fine
Sheldon Levine (Operator, No Brand Petroleum)	Obstruction of Justice (OOJ) Conspiracy		
Oscar Porcelli (Operator, Ditmas Oil)	Mail Fraud		

DEFENDANT	INDICTMENT	CONVICTION	SENTENCE
James Garcia Sorrentino (Operator, Save-On Petroleum)	Mail Fraud		
Pedro Paredes	Mail Fraud		
Joseph Skolnick (Operator, Capitol Ent.)	Offering a False Instrument		
Michael Markovitz (Operator, Gas Stop, Inc.)	Offering a False Instrument		
Gerald Friedberg (Operator, Lewis Petro Chemical Corp., Seaplane Shuttle Corp.)	Grand Larceny, Falsifying Business Records (FBR), CS, CETE		
Igor Roizman (Operator, Greenstar Petroleum)	Grand Larceny, FBR, CS, CETE		
Igor Portsky (Co-operator, Greenstar Petroleum)	Grand Larceny, FBR, CS, CETE		
Nicky Dozortcev	Grand Larceny, FBR, CS, CETE		
Gerald Teisch	Grand Larceny, FBR, CS, CETE		
Muhammet Ozen (O.B. Ent.)	Larceny		
Michael Morgano (O.B. Ent.)	Larceny		
Ismet Kipchik (O.B. Ent.)	Larceny		

Thank you for the opportunity to comment on this serious national problem.

Sincerely,

John R. Bolton
Assistant Attorney General

Chairman PICKLE. Our next panel will be a panel consisting of Mr. O. Donaldson Chapoton, Mr. James I. Owens, and Mr. Anthony J. McMahon.

If you gentlemen will come to the witness table, please.

Our first witness will be Don Chapoton, Deputy Assistant Secretary for Tax Policy. Then we will hear from James Owens, Acting Commissioner for the IRS; and then we will hear testimony from Mr. Anthony J. McMahon, Chief Counsel of the Federal Highway Administration.

First, Mr. Chapoton, we will ask you to proceed. Do you have a written statement?

STATEMENT OF O. DONALDSON CHAPOTON, DEPUTY ASSISTANT SECRETARY FOR TAX POLICY, DEPARTMENT OF THE TREASURY

Mr. CHAPOTON. Yes, Mr. Chairman, I do. The written statement has been filed, I believe.

Chairman PICKLE. All of you gentlemen's statements will be included in the record. If you would like to summarize, that would be satisfactory.

Mr. CHAPOTON. I would like to summarize my statement. Some of what is in the statement has been said already today. And it is a longer statement.

I would like to express my appreciation for the opportunity to appear here and to express the Treasury's views on what appears to be a very serious compliance problem in connection with gasoline tax evasion. The other witnesses that have appeared and that will appear have covered various aspects of this problem, and I would like to direct my testimony to three points.

First is the history and the current requirements for the paying of this tax, second, the difficulties in obtaining reliable estimates of the annual revenue loss resulting from this tax compliance problem, and third the legislative options that we believe this subcommittee should consider in dealing with this compliance problem.

This gasoline tax, which was originally imposed I believe in the early forties, is imposed on the producer. In 1985, the total receipts from this tax were $9 billion. And this money goes to the highway trust fund to support repairs of our highways. This tax is on the producer, and prior to 1956 the tax was paid on the sale by the producer to wholesale distributors, or even to retailers where that occurred.

The concern was expressed in the 1950's by the distributors that they were at a competitive disadvantage with the integrated producers. The integrated producer, who also had wholesale distributors, and even retailers, would not be obligated to pay the tax until it sold the product to the retailer or, in some cases, to the consumer. So, the distributors prevailed upon the Congress to amend the law to provide that distributors would be included within the definition of producers. And, by having this broadened definition of the term "producer," when a producer sold the product to a distributor no tax was owed at that time.

Under this mechanism the tax was not owed until sold to a nonexempt party, either a distributor, who did not have an exemption, or ultimately to a retail outlet.

This definition, incidentally, was again amended in 1984 to broaden it some more by having the term "producer" expanded to include retail outlets if the owner controlled 10 or more service stations. So, the definition of "producer" under the current law is very broad.

What this means is—and what we have been hearing today is—that it is easier for someone to come in and take the position that they are a producer within the definition of the law and therefore not pay the tax until later down the chain. The procedure for being a tax-exempt producer, as you have heard, is obtaining an exemption certificate from the IRS, by filing a form 637 and, upon presenting this to a producer or an upstream wholesale distributor who has an exemption, no tax is owed, and the tax is not owed until the distributor sells to a non-tax-exempt party.

What has happened, as we have heard, is that these distributors have obtained tax exemptions by one form or another, and therefore by setting up a daisy chain situation of companies with tax exemption, the title to the gas changes hands again and again. Ultimately, it is sold to a nonexempt party. The tax is paid by that nonexempt party, and that money is collected by someone in this chain of distribution.

But, when the IRS attempts to determine who in that chain of distribution has that money and where it can be collected, that is very difficult to do because often these companies are dummy companies or sham companies or they are using taxpayer exempt numbers which have been obtained by bona fide businesses. But the bona fide businesses have either gone out of business or the bona fide businesses have been coerced to allow the criminal elements to use their tax exemption.

We think that what we have seen—and I think others will comment on this more—is that an audit of these schemes is actually not terribly productive since it will often turn out that the party with the money, the distributor, is a sham company which will simply disappear and have no assets, and therefore makes the money very difficult to collect.

We think this is a very serious problem. It not only causes loss of respect for the tax system but, in addition, it is putting a lot of pressure on bona fide businesses to do something because they are having difficulty competing with those who are not paying the taxes. So, we consider this as a very significant problem. Determining just how significant it is from the standpoint of loss to the Government, the revenue loss, that is a very difficult situation.

The extent of the gasoline tax evasion nationally and its impact on the highway trust fund depends on a lot of data which we have collected and studied, but from which it is difficult to draw any precise conclusions. This is because the data from each source incorporates estimates, includes reporting and processing errors, and it contains coverage differences that render comparisons in some cases meaningless.

Nevertheless, we have studied this data over a number—over several years now, and we have found from these studies that there is a consistent discrepancy between the total gasoline supplies reported by the IRS and that reported by the Federal Highway Administration. The Highway Administration supplies have historically been——

Chairman **Pickle**. Say that again.

Mr. **Chapoton**. The total gasoline supplies shown by the Highway Administration have consistently been higher than the figures which the Internal Revenue Service tax collection reports would indicate is the total gasoline supplies in the economy. That is an anomaly. And we are trying to analyze what that anomaly means. But we cannot rely on that too greatly because of these discrepancies.

These reports are made for different purposes. They are made at different times and they are based on a different set of data.

I was about to say that, despite our uncertainty about these amounts, we have noticed this inconsistency and we have attempted to determine what is a reasonable estimate on the spread, to the extent that we can, adjusting these figures such as we think is appropriate, realizing that these adjustments are in themselves estimates. But we have concluded from that that there is clearly a compliance problem, and that it could be as great as $100 million to $200 million a year.

We are not sure that we see much greater than that, but these are based on such inconsistent and imprecise data that we cannot make a precise statement one way or the other.

Chairman **Pickle**. The first witness this morning said probably the losses are as much as $1 billion and the two gentlemen representing Justice and the FBI indicated it might be as much as a million dollars. You say $200 million. That is a discrepancy between your estimate and their estimates. The fact of the matter is you don't know, do you?

Mr. **Chapoton**. The fact of the matter is we don't know. We are doing the best we can with the data available and we are backing into these figures—the data we are primarily using is DOE data on motor fuel supply and disposition and another DOE figure which involves the first sales of motor gasoline into the States and that information comes from the States, Mr. Chairman, and that figure is consistently and dramatically higher than the Internal Revenue Service report of tax liabilities.

We have adjusted those figures for what we consider must be some double counting of the amounts and just mistakes and we come out with these figures, but we are not trying to indicate that our figures are at all precise.

But, nevertheless, we do think, we agree with the other witnesses, that there is a serious compliance problem. For this reason, we would make a proposal to this subcommittee. We believe that the solution to this problem lies in changing the imposition of the tax from the point of sale to the nonexempt distributor or retailer to the point at which the gasoline is removed from the refinery or from the terminal in the case of imported refined gasoline.

We realize that exemptions might be required to deal with certain transactions in the trade. The primary thrust of our proposal is that tax compliance can best be achieved if the audit trail is short and attention can be focused on a relatively small number of taxpayers.

Right now dealing with producers, there are over 8,000 taxpayers which must be audited or checked somehow to determine the extent of noncompliance. Our proposal would reduce the total number of taxpayers to between 200 and 300. We have considered a number of other options for trying to deal with this problem, administrative-type options. It is our view that these administrative options trying to have greater enforcement activity under current law, perhaps bonding of taxpayers and things of that nature, we doubt would be significantly effective.

Chairman PICKLE. Does that complete your statement?

Mr. CHAPOTON. I wanted to make the point that some will object to this proposal we are making because we are proposing to move the taxing incident up the stream to the producer, and the main objection, as I understand it, will be—it will require the tax to be paid at an earlier date and that will perhaps put a hardship on some and we realize that. We think that problem can be addressed by delaying the payment of tax, even if the tax is on the producer or someone at an earlier stage, we can delay the tax, so we don't think that is a valid reason for not having this tax moved to an earlier stage.

Chairman PICKLE. You are saying that if you delayed it, you could still have it at the first point?

Mr. CHAPOTON. That is right. We would impose it at the time the tax is moved from the refinery.

Chairman PICKLE. Thank you very much. Pardon the interruption.

[The prepared statement follows:]

For Release Upon Delivery
Expected at 9:00 a.m. EDT
July 15, 1986

STATEMENT OF
O. DONALDSON CHAPOTON
DEPUTY ASSISTANT SECRETARY (TAX POLICY)
DEPARTMENT OF THE TREASURY
BEFORE THE
SUBCOMMITTEE ON OVERSIGHT
OF THE
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES

Mr. Chairman and Members of the Subcommittee:

I am pleased to have this opportunity to appear before you today in order to present the Treasury Department's views on concerns that have been raised with respect to compliance with the federal excise tax on the sale of gasoline. I wish to compliment the members of the subcommittee on holding hearings on this important issue. Representatives of the Internal Revenue Service, the Department of Justice and the Federal Highway Administration, who are also appearing before you this morning, will address in greater detail the issue of compliance with the excise tax on gasoline, how gasoline excise tax evasion schemes are structured, the ongoing civil and criminal enforcement efforts that are designed to deal with gasoline excise tax evasion, and the impact that reduced tax receipts will have on the Highway Trust Fund. I will focus my remarks on the subjects of the requirements under current law for payment of the gasoline excise tax, the difficulties in obtaining reliable estimates of the annual revenue loss resulting from gasoline excise tax noncompliance, and the legislative options that we believe the Subcommittee should consider in addressing this serious tax compliance problem.

Background

Current Law. Under section 4081(a) of the Internal Revenue Code, an excise tax of 9 cents per gallon is imposed on gasoline sold (or used) by the producer or importer of the gasoline. The legal incidence of the tax is on the producer or importer, which is required to file a quarterly excise tax return. A taxpayer must make a monthly deposit of tax if it is liable in any month for more than $100 of taxes. Monthly deposits are due by the last day of the month following the month in which liability is incurred. If a taxpayer is liable for over $2,000 of taxes for any month of a calendar quarter, it must make semi-monthly deposits in the following quarter. Generally, these deposits are due by the 9th day following the close of the semi-monthly period. Independent refiners, however, may pay the tax by the 14th day following the close of the semi-monthly period if the payment is made by wire transfer to the depository.

In 1985 gross gasoline excise tax receipts totaled $8.953 billion. Taxes collected from the gasoline excise tax are paid over into the Highway Trust Fund.

Prior to 1959 the term "producer" was generally understood to mean the refiner of gasoline. Accordingly, the excise tax was imposed upon the refiner or importer at the time the gasoline was sold to a wholesaler or distributor (but not to another producer). In the Federal Highway Act of 1959 (P.L. 86-342), however, Congress amended the statute to provide that the term "producer" included a wholesale distributor. In general, a wholesale distributor is a person who sells gasoline to producers, retailers, or to users who purchase in bulk quantities and deliver into bulk storage tanks. The 1959 change, by delaying the time at which the tax is paid, was intended to reduce a competitive advantage that integrated companies were perceived to hold over independent gasoline distributors and jobbers. In the case of vertically integrated companies, the sale by the producer, and hence the payment of tax, did not occur until the gasoline was sold to the dealer for sale to the ultimate consumer. If a wholesale distributor or jobber purchased gasoline from a producer, however, the distributor or jobber was required to reimburse the producer for the tax upon purchase but could not recoup that cost until it sold the gasoline to a subsequent purchaser. In 1984, Congress further amended the law to provide that the term "wholesaler" includes "chain retailers" having 10 or more gasoline stations under common management.

In order to qualify as a producer, a wholesaler must register with the Internal Revenue Service. This is done by filing Form 637 with the District Director requesting a registration number. Once a wholesaler obtains a registration number, it may purchase gasoline from a refiner or importer tax-free (since the refiner or importer is treated as having sold the gasoline to another producer) and may sell the gasoline purchased tax-free to any other wholesaler holding a Service registration number.

Description of Tax Evasion Schemes. The current law structure of deferring payment of the tax until a sale is made to the retailer (or ultimate consumer in some cases) was adopted as an accommodation for independent marketers and jobbers. As such, it is a departure from the general practice of collecting excise taxes at the point of initial sale by a producer as, for example, is done in the case of the other manufacturers excise taxes (*e.g.*, on tires, coal, and recreational equipment), the tobacco and alcohol beverage excise taxes, and the crude oil windfall profit tax. In recent years, criminal elements have seized upon this weakness in the collection system as a means of diverting for themselves the excise taxes, both Federal and State, that are due upon the sale of gasoline. During fiscal years 1983 to 1986 (through April 30, 1986), there have been criminal convictions in cases involving nearly $4 million in gasoline excise tax deficiencies. Approximately $2 million of these deficiencies are attributable to convictions during this fiscal year alone. In addition, a Justice Department criminal strike force and the Internal Revenue Service Criminal Investigation Division have more than 30 other cases under investigation.

A typical gasoline excise tax evasion scheme involves "paper" sales of gasoline by a refiner or wholesaler through a chain of distributors, each of which qualifies as a distributor because it has obtained a registration number from the Service. Some of these exempt entities may be nothing more than post office boxes with no assets and with officers who are foreign domiciliaries. Others may conduct some bona fide sales while permitting the use of their exemption certificate by criminal elements for other sales. A taxable sale is ultimately made to a non-exempt entity, such as a gasoline distributor that has not registered as a producer or a retailer. The non-exempt distributor or retailer's payment to the last tax-exempt entity in the chain ostensibly includes the Federal excise tax. The tax collected, however, is retained by the participants in the sales chain and is not paid over to the Federal government as is required under the law. In the meantime, the product itself has been shipped directly to the non-exempt distributor for distribution or to the retailer for sale to consumers.

An audit of these paper transactions would reveal that the non-exempt distributor or retailer bought product tax-paid. The final "producer" in the paper chain that sold the gasoline to such a non-exempt person, and that is thus liable for the tax, may ultimately be discovered by tracing the transfers of title to the gasoline, either from the point of retail sale or the point of refinement or importation. These evasion schemes are designed, however, in such a way as to make tracing difficult. Furthermore, the Internal Revenue Service auditor would often discover that, once located, the "producer" that sold the gasoline to the distributor would have no assets or officers that could be held accountable for the unpaid taxes.

In addition to the obvious concerns regarding the loss of tax revenues to the Federal and State governments and the concomitant loss of respect for tax administration inherent in these schemes, there is also the perverse impact that these criminal activities have on the marketplace. Dishonest distributors who evade the gasoline excise tax may undersell their competitors and thereby drive law-abiding distributors out of the marketplace and place great pressure on dealers to purchase untaxed gasoline from criminal elements if they are to survive. Thus, the continued existence of these schemes has a corrupting effect on the entire gasoline distribution system.

Estimate of Revenue Loss and Adequacy of Federal and State Gasoline Data. The extent of the gasoline excise tax evasion nationally and its impact upon the Highway Trust Fund is difficult to estimate. We have attempted to measure the extent of non-compliance with the Federal gasoline excise tax by comparing gasoline tax liabilities reported to the Service with reports of domestic gasoline supplies available during these same periods. However, the available Federal and State data are not sufficiently free from measurement error to permit a definitive conclusion regarding the extent of non-compliance. because the data from each source incorporate estimates, include reporting and processing errors, and contain coverage differences that render comparisons unreliable.*/

Notwithstanding the measuring difficulties, we have discerned a consistent discrepancy between gasoline gallonage reported by the Internal Revenue Service and that reported by the Federal Highway Administration. The Federal Highway Administration reported gasoline gallonage has historically been somewhat higher than the quantity of taxed gasoline implied by the Internal Revenue Service reported tax liabilities. Overall, our estimates suggest a possible federal compliance problem that could be as great as $100 to $200 million per year.

Although we cannot freely extrapolate from the known criminal cases, which have been limited mostly to the New York metropolitan area and the State of Florida, the cases confirm our serious concerns regarding potential future revenue losses. Unless this problem is addressed by the Congress, these cases will serve as a blueprint for other unscrupulous individuals to evade Federal gasoline taxes.

Legislative Options

Administration Proposal. The Administration believes that the solution to the gasoline excise tax evasion problem lies in changing the imposition of tax from the point of sale to a non-exempt distributor or retailer to the point at which the gasoline is removed from the refinery (or the terminal in the case of an imported refined gasoline). Exceptions may be required to deal with certain transactions common within the trade, and I will discuss these. As a general rule, however, tax compliance can be best assured if the audit trail is short and attention can be focused on a relatively small number of taxpayers. Collection at the refinery or terminal would reduce the number of taxpayers to be audited (and burdened with return requirements) from approximately 8,200 today to between 200 and 300. In addition, because the time of tax payment will not depend upon whether the gasoline is distributed directly by refiners or through independent marketers, integrated companies will not have the tax deferral advantage over independent marketers that existed prior to 1959 and prompted the 1959 amendment to the Internal Revenue Code.

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*/For example, the Internal Revenue Service quarterly report of gasoline tax liabilities represents for each quarter the amount of tax reported by taxpayers on returns processed during the following quarter. Changes in processing practices have affected the quarterly reported amounts. Moreover, until the most recent quarter, gasohol tax liabilities were not reported separately. The estimated amount of federally taxed gasoline for 1985 (102.4 billion gallons) is, in part, derived by including Federal Highway Administration estimates of gasohol produced. In addition, because of processing delays, that total may not fully reflect the amount of taxes paid for the 1985 liability year.

We have considered other options that would attempt to improve the operation of the existing tax collection system. These include imposing a requirement for bonding distributors and having the Service exercise greater scrutiny of applicants for exemption and take other more strenuous administrative enforcement measures. It appears to us that while these options may provide some assistance in obtaining additional compliance they would not be generally effective. We believe that they would significantly increase administrative costs to both taxpayers and the Service while failing to effectively deal with the root cause of the problem -- the ability to arrange for the serial transfer of title among many entities. Bonding, for example, as a condition of registering as a producer is of little benefit if time-consuming auditing of multiple transactions is required in order to locate the entity where the diversion has taken place or if bonding is abandoned after an exemption certificate has been obtained.

As Acting Commissioner Owens reports in his testimony this morning, the Service is seeking to attack this problem on many fronts through administrative means. Because such measures cannot assure continuous supervision of the certificates, however, they can be overcome. Non-qualified entities can obtain certificates through the use of "fronts" involving independent dealers who may be coerced or bribed into obtaining exemptions. We also have had reports that, in some cases, criminal groups have offered to purchase an outstanding exemption from a legitimate distributor. Accordingly, we do not believe that such administrative options will stem the revenue loss from the avoidance schemes summarized above.

New York State, which formerly collected its gasoline taxes when distributors sold to dealers, changed its collection system on June 1, 1985, to require the taxes to be paid when companies bring gasoline into the state. We understand that New York State officials, who will testify before you this morning, will report that collections of state taxes have increased significantly because of better compliance resulting from the change in the point of payment of the tax.*/

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*/For some years there has been concern among State and Federal taxing authorities concerning possible non-compliance with the diesel excise tax which is imposed at the retail level. Problems involving data sources similar to those described above with respect to compliance with the gasoline excise tax make it difficult to determine whether there is a serious compliance problem. The Internal Revenue Service has undertaken studies to learn the extent of the problem. We do not now propose that the diesel fuel tax be shifted to the refiner level. Because of the difficulty of distinguishing between diesel fuel and heating oil, and the greater proportion of diesel fuel that is used for non-taxable off-highway purposes, a refiner-level tax would be more difficult to apply in the case of diesel fuel than in the case of gasoline. In any event, we should not allow the more difficult diesel fuel issue to distract us from the need to deal with the evasion of gasoline excise taxes.

Modifications to General Rule. Certain trade practices require modifications to the general rule we have proposed. For example, in some instances refiners or importers sell gasoline to other refiners for further processing. Gasoline also is exchanged among refiners or wholesalers and some gasoline is sold for blending purposes, as in the case of the production of gasohol. Such transactions may require procedures for exemption from the general requirement that the tax be imposed upon initial sale at the refinery or terminal. We are prepared to work with the Subcommittee to develop exemption procedures for dealing with these limited sets of circumstances.

Other Considerations. By postponing the taxable event until ultimate sale to a non-exempt distributor or retailer, current law has the effect of deferring the time of tax payment. This relieves distributors and jobbers of the need to bear the cost of the tax on gasoline until it is sold to a non-exempt person, such as a retailer. Our proposal to change the point at which the tax is imposed would, of course, result in an acceleration in tax payments. Some have argued that such an acceleration would hamper the ability of cash-short independent marketers to compete with major marketers. Others have argued that acceleration of the taxable event will impose a financial burden on refiners who grant marketers and jobbers grace periods for payment on sales of gasoline. If the Subcommittee is concerned that our proposal would injure such taxpayers by accelerating tax payments, the acceleration could be reduced or eliminated by delaying the deposit requirements. We would be pleased to work with the Subcommittee in dealing with this issue.

Conclusion

The evasion of Federal gasoline excise taxes presents a serious tax compliance problem. We are pleased that this Subcommittee has afforded us this opportunity to present the Administration's views on legislative options that will limit these abuses. We are concerned that, unless changes are made in the current method of collecting such taxes, evasion schemes of the kind described will proliferate, thereby reducing the funds available for highway construction and further undermining public respect for our tax system. Consequently, we urge the Congress to adopt the legislative proposal that is described above.

Chairman PICKLE. I want to make one statement along the lines you have just commented on because you indicated we don't have enough data to know what is happening. The staff tells me that DOE data on gasoline sales and inventory show opposite and inconclusive results. One set of numbers show that the amount of excise taxes collected is too low in relation to the volume of gasoline in existence, yet, on the other hand, another set of numbers show that we have excise tax payments on more gallons of gasoline than exist. Other data shows other things.

So the fact is we don't really know, and if this is as an enormous problem as you say then we had better address ourselves to finding a solution. I want to comment on your testimony, but we will go to other witnesses and come back to general questions.

Chairman PICKLE. Mr. Owens, if you will proceed.

STATEMENT OF JAMES I. OWENS, ACTING COMMISSIONER, INTERNAL REVENUE SERVICE

Mr. OWENS. Thank you, Mr. Chairman.

I ask that my full statement be inserted in the record and I will try to summarize that.

Chairman PICKLE. Without objection.

Mr. OWENS. I appreciate the opportunity to discuss compliance issues relating to the Federal excise tax on the sale of gasoline. Because of the potential for tax-free sales from producer to producer, the definition of what constitutes a producer is a key, I think, to an understanding of gasoline excise tax administration. In fact, the term "producer" is extremely broad, including importers, refiners, compounders, blenders, dealers selling exclusively to producers, and wholesale distributors. In addition, the Tax Reform Act of 1984 expanded the term "wholesale distributor" to include so-called chain retailers; that is, persons who purchase gasoline from a producer and distribute gasoline to 10 or more retail gasoline stations under the chain retailer's management.

Until 1959, wholesale distributors had incurred the tax at the time they purchased their product from their supplier. A change made by the Federal Highway Act of 1959 allowed wholesale distributors to elect to register with the Internal Revenue Service and be treated as producers for the purpose of collecting and remitting the tax. The election to be treated as a producer qualifying for tax-free purchases is made on form 637. These forms are subject to review and periodic followup by the district. Consequently, a wholesale distributor may purchase gasoline tax free after being issued a registration number by the district director in the State where it is located.

Producers subject to the gasoline excise tax are required to file a quarterly excise tax return, form 720. Producers accruing a total excise tax liability of more than $2,000 per month—the majority of cases—are required to make twice monthly deposits of tax. Producers with a liability of less than $2,000 make less frequent deposits.

Various purchasers of gasoline are statutorily exempt from payment of the tax. For example, State and local governments, including governmental entities such as school districts, are exempt from the tax. These exemption rules have been interpreted to extend exempt sales to organizations fulfilling a governmental function, such as volunteer fire departments and rescue squads.

The Internal Revenue Service has several responsibilities in connection with the collection of the gasoline excise tax. The IRS processes applications for tax-free transactions, form 637, and the quarterly excise tax returns, form 720. IRS also collects and accounts for the tax.

To help districts identify potential noncompliance for all types of excise taxes, an annual report is extracted from our file of all business taxpayers. This report is printed and distributed to the appropriate district. This list includes data for each taxpayer filing a form 720 and is reviewed by excise tax specialists to identify potential noncompliance. Information from these reports currently provides significant leads for the tax examination program. Currently, we are developing other approaches to identify noncompliance.

One approach to identify potential gasoline tax noncompliance is through information gathering projects. This approach is used when information indicating potential noncompliance is obtained from other Government agencies, informants, or other sources. One such project used information from the Department of Energy to identify the importers of gasoline during 1981, 1982, 1983, and 1984. Another source of leads for the excise tax examiner are referrals from other IRS functions such as collection, criminal investigation, or income tax examiners.

Our experience in examining gasoline excise tax returns has identified noncompliance resulting from usage of incorrect tax rates and failure to file the form 720. In addition, taxpayers make errors in characterizing certain sales as tax exempt.

For fiscal year 1985, civil examinations of the gasoline excise tax yielded an average of $10,314 per return for the 2,937 returns examined. A total of $30.3 million in tax, penalty and interest was proposed by the Examination Division in fiscal year 1985. Examination's coverage was 9 percent of the 34,241 returns filed for the period.

One of the best approaches to identify noncompliance is through information sharing with the States. Many districts obtain copies of State examination reports, lists of registrants or licensees, and other State data that can be used to identify noncompliance.

In 1985, the Internal Revenue Service entered into an agreement with the National Association of Tax Administrators to conduct a joint examination project for cooperative Federal-State enforcement of motor fuel taxes. This project is directed toward better identification of noncompliance through increased coordination between State motor fuel tax enforcement officials and the IRS.

The first project test, initiated in August 1985, was conducted with five States—California, Florida, Maryland, Pennsylvania, and South Carolina—and was limited to excise taxes on diesel fuel. Although the diesel fuel tax is a retail, not a manufacturers' tax, some of the compliance problems are similar. A gasoline tax test phase is now underway.

Much of our recent activity in the gasoline excise tax area has centered on criminal investigations of tax evasion. These investigations have been focused in the Brooklyn district. IRS personnel in Brooklyn have participated in a task force comprised of approximately 40 people representing 12 State and Federal investigative or prosecutorial organizations. This 2-year effort has identified major evasion schemes throughout the entire New York City and Long Island metropolitan areas. The investigation has also uncovered evidence of extensive organized crime involvement. In addition to these areas, we have other cases against individuals, not identified with organized crime, in six of the seven regions.

There are several variations of the schemes being used to evade the excise tax on gasoline. The schemes have one thing in common—the shifting of liability for the tax to an entity that will never pay it. This involves using a series or daisy chain of companies. Some of these companies are actual operating companies and some are shell companies that have no more substance than a post office box. Under these schemes, gasoline is purchased tax-free from a refiner, importer, or a legitimate broker or distributor. This gasoline is then bought and sold through a series of transactions involving several businesses entitled to engage in tax-free transactions. At some point in this series of transactions, the invoices associated with the transfers of gasoline reflect that the tax has already been paid by the seller. In reality, the tax is never paid to the government. Upon examination, the wholesale distributor or producer liable for the tax exists only on paper. It either cannot be located or goes out of business after having accrued substantial liability with no assets available to secure payment. The huge amount of cash involved is then laundered through apparently legitimate front companies, through banks, or is exported to tax haven countries. Variations include having a sham corporation use the exempt registration number previously issued to a legitimate company that has gone out of business or has been compromised through strong arm tactics.

The IRS recognizes the severe compliance problems in this area. Consequently, based on the present law's tax collection scheme, the Service has undertaken a number of initiatives to improve gasoline excise tax compliance.

Some of these initiatives include the following:

One, the IRS plans to substantially increase the resources devoted to this area. It is anticipated that the number of diesel and gasoline returns examined will be increased by 76 percent from 18,566 planned in fiscal year 1986 to 32,670 in the proposed fiscal year 1987 plan.

Two, the cooperative Federal-State exchange project was expanded. This phase was implemented during May 1986 in six States.

My complete statement reflects other actions the Service will be taking in that area.

While the IRS is currently devoting resources to this program and intends to devote additional resources in the future, the current gasoline excise tax collection system is unnecessarily complex and unwieldly. Tracking the paper trail of ownership of gasoline through a chain of transactions involves the examination of the records of a series of both related and unrelated taxpayers. An additional difficulty is that our examination always occurs some months after the evasion of the tax. In fact, frequently no return whatsoever is filed and the IRS has little, if any, information to begin its investigation or examination.

The current system poses basic practical problems of the use in staff resources, the coordination of examinations, the potential for continuing reexaminations of the same taxpayers and other difficulties.

Further, since the most troubling of these evasion schemes are criminal tax cases, it is doubtful that any civil enforcement program of reasonable size would reach the goal of compliance. The large number of potential taxpayers, the volume of sales of gasoline, the ability to create new paper entities to purchase gasoline tax free, and the ability to transfer funds offshore or otherwise launder proceeds of this illegal activity all suggest that the current system should be changed to move the responsibility for payment of the tax up the sales chain to the comparatively small number of true producers of gasoline.

We have worked with the Treasury Department in developing the proposal which they have presented this morning. We wholeheartedly endorse this proposal. At the conclusion of the testimony, my colleagues and I will be available to answer any questions you might have on current compliance issues.

Thank you very much.

Mr. GUARINI. Thank you, Commissioner Owens.

[The prepared statement follows:]

Opening Statement
James I. Owens
Acting Commissioner of Internal Revenue
Before the
Subcommittee on Oversight
House Ways and Means Committee

July 15, 1986

Mr. Chairman and Members of the Subcommittee:

I appreciate the opportunity to discuss compliance issues relating to the federal excise tax on the sale of gasoline. With me today are representatives from several Service functions that are involved in this issue. All of us will be available to try and answer any questions you or the Members may have at the conclusion of my statement.

Background

Section 4081 of the Internal Revenue Code imposes an excise tax on certain sales of gasoline. The federal excise tax on gasoline was first imposed in June 1932 at the rate of one cent per gallon. Since 1932 the tax increased to 1 1/2 cents a gallon in July 1940, to four cents a gallon in October 1959, and most recently to nine cents per gallon in April 1983. All revenues derived from the Federal excise tax on gasoline are earmarked for the Federal-Aid Highways Account (Trust Fund), administered by the Federal Highway Administration of the Department of Transportation. The gasoline excise tax is scheduled to expire on October 1, 1988.

Generally, the gasoline excise tax is imposed at the time of a gasoline producer's first sale of the product in the United States. The gasoline may also be sold to another producer tax-free. If sold tax-free to another producer, it becomes the responsibility of the producer purchasing the gasoline to pay the tax when the gasoline is sold to a non-exempt entity.

Definition of Producer

Because of the potential for tax-free sales from producer to producer, the definition of what constitutes a producer is key to an understanding of gasoline excise tax administration. In fact, the term producer is extremely broad. The term producer includes importers, refiners, compounders, blenders, dealers selling exclusively to producers, and wholesale distributors. In addition, the Tax Reform Act of 1984 expanded the term "wholesale distributor" to include so-called chain retailers; that is, persons who purchase gasoline from a producer and distribute gasoline to ten or more retail gasoline stations under the chain retailer's management.

Until 1959, wholesale distributors had incurred the tax at the time they purchased their product from their supplier. A change made by the Federal Highway Act of 1959 allowed wholesale distributors to elect to register with the Internal Revenue Service and be treated as producers for the purpose of collecting and remitting the tax. The election to be treated as a producer qualifying for tax free-purchases is made on Form 637. These forms are subject to review, and periodic follow up by the District. Consequently, a wholesale distributor may purchase gasoline tax free after being issued a registration number by the District Director in the state where it is located.

Payment of Tax

Producers subject to the gasoline excise tax are required to file a quarterly excise tax return, Form 720. Producers accruing a total excise tax liability of more than $2,000 per month -- the majority of cases -- are required to make twice monthly deposits of tax. Producers with a liability of less than $2,000 make less frequent deposits.

Various purchasers of gasoline are statutorily exempt from payment of the tax. For example, state and local governments (including governmental entities such as school districts) are exempt from the tax. These exemption rules have been interpreted to extend exempt sales to organizations fulfilling a governmental function such as volunteer fire departments and rescue squads.

In addition, the statute provides a partial exemption for gasoline that will be blended in a mixture which contains at least 10 percent alcohol (ethanol or methanol). This mixture commonly is referred to as gasohol and often is marketed as octane enriched unleaded gasoline. Gasohol currently qualifies for a partial exemption from the excise tax. The effective rate on gasohol is three cents per gallon.

Compliance Efforts in Examination

The Internal Revenue Service has several responsibilities in connection with the collection of the gasoline excise tax. The IRS processes applications for tax-free transactions (Form 637) and the quarterly excise tax returns (Form 720). IRS also collects and accounts for the tax.

To help districts identify potential noncompliance for all types of excise taxes, an annual report is extracted from our file of all business taxpayers. This report is printed and distributed to the appropriate district. This list includes data for each taxpayer filing a Form 720 and is reviewed by excise tax specialists to identify potential noncompliance. Information from these reports currently provides significant leads for the tax examination program. Currently, we are developing other approaches to identify noncompliance.

One approach to identify potential gasoline tax noncompliance is through "information gathering projects". This approach is used when information indicating potential noncompliance is obtained from other government agencies, informants, or other sources. One such project used information from the Department of Energy to identify the importers of gasoline during 1981, '82, '83, and '84. Another source of leads for the excise tax examiner are referrals from other IRS functions such as Collection, Criminal Investigations or income tax examiners.

Our experience in examining gasoline excise tax returns has identified noncompliance resulting from usage of incorrect tax rates and failure to file. In addition, taxpayers make errors in characterizing certain sales as tax exempt.

For Fiscal Year 1985, civil examinations of the gasoline excise tax yielded an average of $10,314 per return for the 2,937 returns examined. A total of $30.3 million in tax, penalty and interest was proposed by the Examination Division in FY 1985. Examination's coverage was 9 percent of the 34,241 returns filed for the period. The yield to cost ratio for gasoline and diesel examination results for FY 1985 was 10.95 to 1.

Federal/State Cooperation

One of the best approaches to identify noncompliance is through information sharing with the states. Many districts obtain copies of state examination reports, lists of registrants or licensees, and other state data that can be used to identify noncompliance.

In 1985, the Internal Revenue Service entered into an agreement with the National Association of Tax Administrators to conduct a joint examination project for cooperative Federal - State enforcement of motor fuel taxes. This project is directed toward better identification of noncompliance through increased coordination between state motor fuel tax enforcement officials and the IRS.

The first project test, initiated in August, 1985, was conducted with five states (California, Florida, Maryland, Pennsylvania, and South Carolina) and was limited to excise taxes on diesel fuel. Although the diesel fuel tax is a retail, not a manufacturers' tax, some of the compliance problems are similar.

Through this project the IRS and state examination personnel shared information to identify noncompliant taxpayers; shared methods and techniques on diesel fuel examinations; and jointly prepared a final report including recommendations on how to better identify and reduce noncompliance with diesel fuel tax reporting. The first phase was completed in March 1986 and the report and recommendations are being reviewed by the IRS and the participating states.

Criminal Enforcement Actions

Much of our recent activity in the gasoline excise tax area has centered on criminal investigations of tax evasion. These investigations have been focused in the Brooklyn District. IRS personnel in Brooklyn have participated in a task force comprised of approximately 40 people representing 12 state and federal investigative or prosecutorial organizations. This two year effort has identified major evasion schemes throughout the entire New York City and Long Island metropolitan areas. The investigation has also uncovered evidence of extensive organized crime involvement. In addition to these areas, we have other cases against individuals, not identified with organized crime, in six of the seven regions.

There are several variations of the schemes being used to evade the excise tax on gasoline. The schemes have one thing in common - the shifting of liability for the tax to an entity that will never pay it. This involves using a series or "daisy chain" of companies. Some of these companies are actual operating companies and some are shell companies that have no more substance than a post office box. Under these schemes, gasoline is purchased tax-free from a refiner, importer, or a legitimate broker or distributor. This gasoline is then bought and sold through a series of transactions involving several businesses entitled to engage in tax-free transactions. At some point in this series of transactions, the invoices associated with the transfers of gasoline reflect that the tax has already been paid by the seller. In reality, the tax is never paid to the government. Upon examination, the wholesale distributor or producer liable for the tax exists only on paper. It either cannot be located or goes out of business after having accured substantial liability with no assets available to secure payment. The huge amount of cash involved is then laundered through apparently legitimate front companies, through banks, or is exported to tax haven countries. Variations include having a sham corporation use the exempt registration number previously issued to a legitimate company that has gone out of business or has been compromised through "strong arm" tactics.

Planned Actions

The IRS recognizes the severe compliance problems in this area. Consequently, based on the present law's tax collection scheme the Service has undertaken a number of initiatives to improve gasoline excise tax compliance.

Some of these initiatives include the following:

1. The IRS plans to substantially increase the resources devoted to this area. It is anticipated that the number of diesel and gasoline returns examined will be increased by 76% from 18,566 planned in FY 86 to 32,670 in the proposed FY 87 Plan.

2. The Cooperative Federal-State Exchange Project was expanded from diesel fuel to include a gasoline tax phase. This phase was implemented during May 1986 in six states (California, Illinois, Louisiana, New York, New Jersey, Florida), and includes 10 targets in each state.

3. Training materials are currently being updated to better assist identifying schemes previously discussed. Joint training sessions are being prepared, to consist of representatives from our examination and criminal investigation functions, as well as civil and criminal enforcement personnel from the states. These sessions should result in better cooperation and enforcement efforts between federal and state personnel.

4. In April 1986 a memorandum was issued to all Assistaht Regional Commissioners (Examination). The memorandum stressed the need for districts to ensure the use of quality examination techniques during the examination of such cases. Income probes and package audits were encouraged to help reduce noncompliance.

5. There is a concerted effort by our compliance personnel in identifying fraudulent schemes. Contacts are being made with state officials, industry groups and other federal agencies to solicit information, cooperation and assistance. In addition, our special agents are using such law enforcement techniques as undercover operations, surveillance, and informants, to identify fraudulent schemes and the perpetrator of such schemes.

6. A closer review of the exemption requests to determine possible organized crime relationships or other potential criminal involvement by applicants.

Conclusion

While the IRS is currently devoting resources to this program and intends to devote additional resources in the future, the current gasoline excise tax collection system is unnecessarily complex and unwieldy. Tracking the paper trail of ownership of gasoline through a chain of transactions involves the examination of the records of a series of both related and unrelated taxpayers. An additional difficulty is that our examination always occurs some months after the evasion of the tax. In fact, frequently no return whatsoever is filed and the IRS has little, if any, information to begin its investigation or examination.

The current system poses basic practical problems of the use in staff resources, the coordination of examinations, the potential for continuing reexaminations of the same taxpayers and other difficulties. Further, since the most troubling of these evasion schemes are criminal tax cases it is doubtful that any civil enforcement program of reasonable size would reach the goal of compliance. The large number of potential taxpayers, the volume of sales of gasoline, the ability to create new paper entities to purchase gasoline tax-free, and the ability to transfer funds offshore or otherwise launder proceeds of this illegal activity all suggest that the current system should be changed to move the responsibility for payment of the tax up the sales chain to the comparatively small number of true producers of gasoline.

We have worked with the Treasury Department in developing the proposal which they have presented this morning. We wholeheartedly endorse this proposal. At the conclusion of the testimony my colleagues and I will be available to answer any questions you might have on current compliance issues.

Mr. GUARINI. Mr. Anthony J. McMahon, Chief Counsel of the Federal Highway Administration.

STATEMENT OF ANTHONY J. McMAHON, CHIEF COUNSEL, FEDERAL HIGHWAY ADMINISTRATION

Mr. McMAHON. I have submitted my formal statement and ask that that be included in the record.

Mr. Chairman, members of the subcommittee, the Federal Highway Administration would like to express its gratitude for convening this hearing to inform yourselves and your colleagues of a potentially disastrous loss of Federal tax revenues which cries out for correction.

You have heard testimony that unscrupulous persons have corrupted the gasoline distribution business and diverted substantial revenues to their own use. We are unable to say with any certitude how much Federal tax money is being misappropriated. However, completed criminal prosecutions and the testimony you have heard today indicates that the amounts of federally evaded taxes runs in the hundreds of millions of dollars per year.

There is certainly no reason to believe that the amount of unpaid tax will decrease. Rather, it will inevitably increase.

Combined State and Federal gasoline taxes range from a low of 16 cents per gallon to 27½ cents per gallon. This represents between 20 and 30 percent of the selling price of gasoline. This provides a strong incentive for tax evasion.

The combined Federal and State revenue from taxes on gasoline exceeds $20 billion a year. Tax evasion at the 2- to 3-percent level, which would be undetectable from data sources available to us, would amount to $400 million to $600 million combined shortfall to the States and the Federal Highway Trust Fund. We wouldn't know about it.

These taxes are intended for the Highway Trust Fund which finances virtually the entire Federal investment in our Nation's highway system.

The money is spent to build and maintain the Nation's interstate, primary, secondary and urban road systems and to replace or rehabilitate structurally unsafe bridges.

The evasion of gasoline taxes represents a most significant loss of funding to every State, not just in those States in which the evasion occurs, for each State receives a share of every highway dollar.

Now, the committee has asked each witness where is this evasion scheme going on, and you have heard a number of States listed. You should also be interested in where the effects of this evasion scheme are felt. They are felt in each of your States.

The taxes which are collected on the Federal gasoline excise tax are put into the Highway Trust Fund, which is administered by the Highway Administration. They are apportioned by the Highway Administration to each of the States. So each State loses.

If the first witness is accurate in his estimate that $1 billion in Federal excise taxes per year is evaded, based on that estimate, and assuming that an additional billion dollars would be appropriated to the use of the Federal Highway Trust Fund, Texas would lose $72 million a year.

If that witness' testimony is correct and if a billion dollars is being evaded, then Texas is losing $72 million a year.

Chairman PICKLE. Mr. McMahon, how do you testify? Is the loss that much?

Mr. MCMAHON. Mr. Chairman, we don't know. As Mr. Chapoton mentioned, the data bases available at the Federal level are inconsistent.

Chairman PICKLE. I agree with you that the losses are enormous. If you say it is so, then the Highway Trust Fund is losing. I have to find out what are the losses and somebody knows that better than we know today.

Mr. MCMAHON. The Federal Highway Administration, Mr. Chairman, does not have adequate data collection resources to be able to say how much we should get.

Chairman PICKLE. You may not know that for certain. We will agree to that so I am not arguing on it. I know the administrator has written to Treasury saying losses, which are enormous, are up to $1 billion.

Mr. MCMAHON. The source of that was from conversations with the FBI, the Department of Justice, the Treasury, the same sources you are hearing from today. If the level of evasion is at the level of 2 to 3 percent, we would not be able to detect it from the data available to us. Losses would amount to $400 to $600 million a year and we wouldn't know it. It is not only the highway program that suffers, although certainly the highway program is important to the country.

We spend this money not only to improve the efficiency of the highway transportation scheme, but most of the funds that are spent on highways go to eliminate safety hazards.

As I said, we rehabilitate structurally unsafe bridges. The losses to the Federal Highway Trust Fund, which are made available to the States, can be measured in lives lost because of unsafe conditions on the highways. Many modifications could be corrected if these funds were available.

The criminal diversion of the tax dollars also has a substantial adverse effect on the Nation's employment. Jobs numbering in the tens of thousands would otherwise be available in both the construction of highways and bridges as well as the manufacture of raw materials.

You have heard a description of the kind of evasion scheme that goes on. The first witness testified as to the daisy chain and there has been a lot of talk about organized crime, but from what I have been able to see in looking into this practice and how it has developed, there are three kinds of participants in the evasion scheme.

It sounded to me like the first witness was trying to say he was what I call the garden variety tax evader. He saw an opportunity to pay less tax than he was required to pay and he declared less of a tax obligation and pocketed the money. Then organized crime figures saw that he had a fountain of money so they decided to be his business partner. He turned to another organized crime organization for protection and they did become his partner.

So you have the garden variety evader who has been in the business for years. Then you see organized crime seeing an opportunity to steal a lot of money, as I say, $20 billion per year is collected at the State and Federal level on gasoline taxes.

The third participant is the honest businessman who is competing with the garden variety evader and the mob. He has a choice. He can suffer extreme economic losses and perhaps go out of business or he can start cutting his payments to the taxing authorities himself.

In the course of my looking into the problem to see whether it existed and if so how much, I spoke with an independent distributor in New York whose name and address I have given to the staff of the subcommittee. He was complaining about having to compete with bootleggers. He chose not to compete with them by evading taxes. He was on the verge of going out of business. He told me that one day he got a call from a fellow who wanted to come see him. This fellow turned up in a brandnew red Mercedes. This fellow offered him $750,000 for the use of his 637 certificate.

They don't just apply to the IRS District Office and get a 637 certificate issued to them. They will move in on an honest businessman and try to get him to participate. So, there are a number of different ways of carrying out this scheme. And, even though organized crime may not be presently active in Texas or California or Oregon or wherever, that is not to say that the garden variety is not operating there.

As I said before, it is our belief based on what we have seen, that the tax losses to the trust fund are enormous. Since we are living in times of budget constraint, if these evaded funds were available to the trust fund, they would greatly enable us to continue to operate on a deficit-neutral basis. They could be used to increase safety on the Nation's highways and bridges, and reduce the Nation's unemployment.

[The prepared statement follows:]

STATEMENT BY ANTHONY J. MCMAHON
CHIEF COUNSEL, FEDERAL HIGHWAY ADMINISTRATION
BEFORE THE SUBCOMMITTEE ON OVERSIGHT, COMMITTEE ON WAYS AND MEANS
ON COMPLIANCE WITH THE FUEL EXCISE TAX

July 15, 1986

Mr. Chairman and Members of the Subcommittee:

As Chief Counsel for the Federal Highway Administration, I want to thank you on behalf of that organization for scheduling this hearing to examine a problem which is of major concern to us, namely, the evasion of payment of excise taxes on gasoline and diesel motor fuels. The Administrator of the Federal Highway Administration, Ray Barnhart, has asked that I voice to you, especially, Chairman Pickle, his genuine disappointment at being unable to testify personally today. In fact, Mr. Chairman, he is in Austin, Texas, the district you have represented for so many years, addressing the annual meeting of the Western Association of State Highway and Transportation Officials.

As you know, the Highway Trust Fund finances virtually the entire federal investment in our Nation's highway systems. In 1986, except for approximately $39 million for certain specified activities funded from the General Fund, the $14 billion Federal-aid highway program is dependent on that fund. The Trust Fund itself is financed by the users of the highway system through payment of federal excise taxes on gasoline and diesel fuels, on large trucks, trailers and truck tires, and the special highway use tax on trucks. By far, the most significant portion of revenues is derived from the gas tax. If that tax is evaded, the national highway program is compromised. I should note that one cent of the nine cent gas tax helps support mass transit activities, which are also jeopardized by gas tax evasion.

The Highway Trust Fund is thirty years old. It was created by an Act of Congress on June 29, 1956, which also gave birth to the Interstate and Defense Highway System. The Trust Fund supports the federal highway program and a large number of transportation and safety programs. The largest program is the Federal-aid highway program, which finances the unique federal-state partnership which builds the Nation's roads and bridges. The lion's share of the money apportioned from the Highway Trust Fund -- $100 billion out of a total $164 billion expenditure -- has been spent on the Interstate System. This system of highways has had, and will continue to have, a tremendous impact on the political, social, and economic lives of Americans. It is the Nation's preeminent means of transportation; it has significantly increased safety and efficiency in the cross-country movement of goods and people. The Trust Fund also pays up to 75 percent of the cost of primary, secondary, and urban roads which are part of the Federal-aid systems.

Today, the Interstate System and the highways on and off the Federal-aid system carry the vast majority of the Nation's goods either all or part of the way to market. Over 90 percent of our textile mill products, 89 percent of our fresh fruits and vegetables, 84 percent of our furniture and fixtures, and 81 percent of our meat and dairy products are transported all or part of the way to market on highways.

You have asked whether the Trust Fund is capable of meeting our current federal road needs, and whether a gap exists between what the Trust Fund is capable of providing and what future demands will be. The Administration's proposal, a $12.8 billion program, is a prudent budget which will enable us to meet basic needs without jeopardizing the investment in the federal road system. Ours is a "deficit neutral" budget, balancing expenditures against tax receipts averaged over the four-year life of the legislation. The tax receipts element of this calculation, it must be stressed, is dependent upon elimination of the gasohol exemption and certain bus exemptions, which total about $600 million per year. The Federal Highway Administration has provided voluminous documentation of these projections to the House Public Works and Transportation Committee on a continuing basis.

The evasion of payment of taxes properly due, thus becomes not only an issue of law and equity, but one of enabling FHWA to assist the states in securing funds to meet their transportation needs. For many years the highway community has been perturbed about the evasion of payment of federal taxes on diesel fuels which are used in highway transportation. As the diesel tax is collected at the retail level, and because diesel motor fuel is virtually indistinguishable from non-taxable home heating fuel, a practicable solution to the evasion problem has not yet been developed. We will continue to investigate the issue.

Simply because there is no immediate solution at hand regarding diesel fuel tax evasion, there is no reason to defer action on closing the loopholes which make gasoline tax evasion possible. FHWA believes there is abundant evidence to suggest that evasion of gasoline taxes has reached a staggering level, and is engaged in not only by some individuals in the fuel industry, but by organized crime as well. As Mr. Chapoton has explained, precise figures cannot be determined; however, revenue losses are clearly substantial. The statement from the Department of Justice describes how the fraud takes place.

We know that in the States of New York and Florida, for example, intensive investigative efforts by local, state, and federal enforcement agencies have uncovered evasion schemes which resulted in significant lost revenue. We understand that this is only the beginning, and that evasion schemes are probably operating in some dozen states.

Combined state and federal gasoline taxes range from a low of 16¢ per gallon to 27.5¢ per gallon, varying from state to state. In some states, taxes represent more than 30 percent of the selling price of the product, and thus there is a strong incentive for evasion. Federal and state revenues from excise taxes on gasoline alone exceed $20 billion a year. The volume of gasoline sold, the hundreds of individuals and corporations engaged in its distribution, the difficulties involved in auditing the complex transactions, and the loopholes available in tax collection procedures, are factors which, when combined, offer high payoffs with minimal risk to tax evaders.

The evasion of gasoline taxes represents a most significant loss of funding to every state, not just to those states in which the evasion occurs, for each state receives a share of every highway dollar. State highway agencies recognize the problem. The American Association of State Highway and Transportation Officials (AASHTO) has just recently adopted a policy resolution expressing its concern about gasoline tax evasion and calling upon Congress and the Administration to enact such changes as are needed to eliminate the practice.

The FHWA believes that the opportunity to evade payment of gasoline taxes could be minimized with some modification of the federal gasoline tax statute itself. In order to ensure the integrity of the collection process, it is necessary to radically reduce the number of entities responsible for paying the tax. This can be achieved by placing responsibility as high on the distribution chain as possible, that is at the level of refiner or first importer. We recognize that any change in the collection system could create problems for segments of the industry. However, we believe that adverse competitive and economic effects can be avoided administratively. Concerns have been expressed to us, and I am sure will be expressed to the Committee, involving loss of cash flow, now enjoyed by distributors by taking away the so-called float; evaporation losses of product on which tax has been paid; the impracticality of selling to exempt purchasers such as school districts and farmers; and the disadvantage to independent distributors competing with major oil companies which are integrated down to the retail level.

These potential adverse affects were confronted by the State of New York when it proposed changes in its own legislation to avoid large scale evasion. The remedial New York law has been in effect for more than a year and it is our understanding that the potential adverse affects which so concerned the industry, have been avoided.

We have no desire to disrupt the level playing field in gasoline marketing. However, prompt action is required. Competitive inequality between independent distributors and integrated majors can be avoided. We are not aware of opposition by the integrated oil companies to paying the tax when it leaves its refinery even though they retain ownership. Loss of product through evaporation and non-availability of the "float" can be alleviated by administrative rule. The Treasury Department has particular expertise in devising transitional rules which avoid economic and competitive dislocations which are of such concern to the industry.

In an ideal world, there would be no exempt purchasers. End-user entities which Congress determines should be exempt could be required to pay the tax and receive a refund.

Blenders, such as gasohol producers, are a separate problem. If this exemption is not removed, we anticipate that by closing one loophole we would open another. We would suddenly see a burgeoning of blenders. We strongly recommend that the Committee consider this in dealing with the overall problem.

In closing, I want to say that Federal Highway Administration is extremely pleased with the responsiveness of the Treasury Department, particularly the IRS, and the Justice Department's Organized Crime Section as well as the Federal Bureau of Investigation in working to discover and punish the unscrupulous corrupters of the gasoline industry who have diverted the flow of funds so desperately needed by the states to build and maintain the Nation's highways and bridges. However, auditors, criminal investigators, and prosecutors cannot do the whole job. The problem is in the process itself and that can only be cured by Congress.

You have my heartfelt gratitude for convening this hearing to inform yourselves and your colleagues of a potentially disastrous loss of federal tax revenues which cries out for correction in these times of budgetary restraint.

I thank the Subcommittee again for its attention and stand ready to answer any questions the Members may have.

Chairman **Pickle**. We thank you for your testimony. I will ask Mr. Owens to respond to this question:

Our committee made an inquiry to the Internal Revenue Service to find out the scope and extent of this tax evasion scheme some 6 months ago, and after this request, you have conducted a survey to try to find out the results.

My question to you is, What did the Internal Revenue Service learn as a result of your survey of regional and district Criminal Investigation Division Offices about the scope and nature of this problem?

What has been the results of your survey?

Mr. **Owens**. Mr. Chairman, we have evidence that there is evasion going on from the east to the west coast. We have, as I said earlier, cases against organized crime figures now. We know that is true, and you have heard more of that this morning. We have cases against individuals, so it is not only organized crime. It is the individuals that are involved also.

Currently, we have some 40 cases in our criminal investigation.

Chairman **Pickle**. Against individuals or organized crime?

Mr. **Owens**. I don't have a breakdown on that.

Chairman **Pickle**. I wish you would give it to us, because we keep hearing you are going after the little guy.

Mr. **Owens**. Those 40 cases cover the west coast as well as the east coast, and in between, so I would say it is not just centered in the New York City metropolitan area.

[The following was subsequently received:]

Analysis of Forty CID Open Cases
Fuel Excise Tax

Region/District	Type of Fuel	Organized Crime Connection
North-Atlantic		
Albany, New York 1 Case (Individual)	Gasoline	No
Brooklyn, New York 23 Cases (15 Individuals & 8 Businesses)	Gasoline (All)	Yes (All)
Mid-Atlantic		
Wilmington, Delaware 1 Case (Individual)	Gasoline and Diesel	Questionable
Southeast		
Greensboro, North Carolina 1 Case (Individual)	Diesel	No
Jackson, Mississippi 1 Case (Individual)	Diesel	No
Jacksonville, Florida 1 Case (Business)	Gasoline and Diesel	Yes
Central		
Detroit, Michigan 4 Cases (Individuals)	Gasoline	No
Indianapolis, Indiana 1 Case (Individual)	Aviation Fuel	No
Midwest		
Springfield, Illinois 4 Cases (Individuals)	Diesel	No
Southwest		
Salt Lake City, Utah 1 Case (Individual)	Diesel	No
Western		
Portland, Oregon 2 Cases (1 Individual & 1 Business)	Diesel	No

Mr. Owens. One other point, we have 40 active cases right now we are investigating, and there are 20 cases that are now in the inventory. The strike force attorney, U.S. attorney, or the Tax Division recommended prosecution on 20 during fiscal year 1986, sir.

Chairman Pickle. All right, my question to you is, what did you find out—is that the answer? When you made this survey to find out how big the problem is nationally, was that your response, that it is national, to such extent you have 20 cases under prosecution now?

Mr. Owens. There are 40 active criminal investigations now going on, and another 20 have been recommended for prosecution.

Chairman Pickle. Let me follow up with a question.

If the Internal Revenue Service were given adequate resources, would gasoline tax evasion be stopped?

Mr. Owens. In my judgment, it would not be stopped and for several reasons. One is, as long as there is an exemption process which allows almost anyone in the chain to buy and sell exempt, then in fact the opportunity is there, and it does not necessarily mean that we can follow up on the 637's.

Could we do more? Certainly we could do more. You don't have to get a number from the IRS. You can buy one, use one of someone that has gone out of business, or you can make one up.

Chairman Pickle. Mr. McMahon, you have testified that this fellow paid $750,000 for his 637. Why didn't he make application for one, mail a 22-cent letter? Maybe he wanted somebody's number in particular?

Mr. McMahon. The New York District Office had tightened up on issuing the 637 certificates, Mr. Chairman.

Chairman Pickle. What you are saying, Mr. Owens, is in line with what the other two gentlemen said, and that is, you need to have a better definition. You should consider the point of first collection, the refinery, better surveillance and auditing, as well as the issuance of the 637, which is too easy to obtain. You need to do a combination of things.

Is that part of your overall recommendation, Mr. Chapoton?

Mr. Chapoton. Yes, Mr. Chairman, it is. One of the main points that needs to be realized is that it so greatly reduces the number of individuals involved. There are some 8,000 different taxpayers now, and this proposal would reduce it to between 200 and 300, so the IRS's job of auditing and checking on these matters would be greatly simplified.

Chairman Pickle. Everybody agrees this thing is so enormous, and yet you are cautious, maybe $200 million is your estimate. You are kind of being cautious, aren't you, overly cautious, and maybe not totally honest?

You just don't know, but it probably is that high?

Mr. Chapoton. I agree, we just don't know. We are struggling with the data and using it as best we can, and it could be significantly higher.

Chairman Pickle. All right.

Mr. Schulze.

Mr. Schulze. Thank you, Mr. Chairman.

Both Mr. Chapoton and Mr. Owens are somewhat new in their positions. As we question you about various areas, if you are not totally up to speed, just tell us and you may send us the information.

The staff has been in contact with the IRS over the last year or so, and finally, the survey was sent out. I understand that the survey information was supposed to be compiled in time for the hearing. Can you give us the five most important things you have learned from that survey?

Give us some kind of a report on factual information that we have gathered.

Mr. **Owens**. I would be happy to, and follow up with anything additional that we might have at the office I might not cover. In doing the survey in the field, we found we do need to tighten up some of the procedures, and it would be helpful to do that for the 637. We would tighten some of the procedures under the 637 exemption certificate.

Mr. **Schulze**. What information led you to that conclusion?

Mr. **Owens**. Just looking at what has occurred in the last several months with taxpayers going across State lines to other districts to get one. We need to have better control of that and more of a centralized file.

Mr. **Schulze**. Your survey showed that there was laxity or lack of control?

Mr. **Owens**. I am not sure the survey showed a lack of control. It showed that there had been a change in the pattern of the taxpayers in how they get the exemption from the Revenue Service.

If we tightened up one district a little more than another, they would go into the more lenient district by giving us an address there. We would need to centralize a file so we would know this, and any agent nationwide could contact that particular control site and determine whether or not a person had an exemption.

Mr. **Schulze**. Is that information computerized?

Mr. **Owens**. No, it is not. It is computerized in some offices, but we need it nationwide. For example, Los Angeles has it computerized, but other districts do not. The tightening of all these procedures, in my judgment as a tax administrator, will not solve the compliance problem, because they don't need to have a certificate. They can make one up on their own.

Mr. **Schulze**. What other conclusions, the 5 or 10 most important?

Mr. **Owens**. Our working with the States has been very, very beneficial. We need to continue that because the States develop information we can use and we can provide them information.

In addition, we have plans to establish a joint training session to train agents in more detail in some of the schemes that we now have uncovered, so they will be familiar with the latest facts.

Mr. **Schulze**. Is this mainly on gasoline tax avoidance, or is this in cooperation with the cigarette tax and other areas?

Mr. **Owens**. Right now, mainly in the gasoline and diesel fuel areas, although we don't have as many cases active in diesel fuel because that is a different issue. The tax attaches when it is sold to the user, so you don't have the exemption process.

Chairman **Pickle**. Would the gentleman yield?

Mr. Owens, to be sure that we understand each other, what results were in your survey, I want the specifics. Would you submit to this committee by regions on a national basis, the findings of that survey, so we will know your results?

Mr. **Schulze**. Do you have any other conclusions to report from the survey?

Mr. **Owens**. Not that I recall at this time. We will provide others for the record.

[The following was subsequently received:]

"Assessment" of Fuel Tax Non-Compliance by Criminal Investigation

A. Summary of regional responses

On April 16, 1986 the Assistant Commissioner (CI) requested an assessment of excise tax non-compliance in each region. We requested the assessment to include the following:

1. Discussion with local revenue and/or enforcement agencies;
2. Discussion with local petroleum industry representatives at various levels of the distribution chain;
3. A review of exemptions granted to wholesalers or distributors; and
4. Discussion with Examination to determine results and ideas from revenue agents in excise tax groups at the district office level.

Our request was not intended to produce an in-depth comprehensive study, but was more an attempt to quickly consolidate in the National Office all information that was already known or readily available in the various districts.

The following is a summary of the regional responses:

North-Atlantic Region

The Brooklyn District has been the focus of nationwide attention as a result of its participation in a task force comprised of approximately 40 people representing 12 investigative/prosecutorial organizations. This two year effort has identified a major non-compliance problem in the entire New York City and Long Island metropolitan area with evidence of wide-spread organized crime involvement. Other parts of New York State may have isolated situations but no evidence to date of organized non-compliance. Other districts in the region have, so far, no evidence of wide-spread non-compliance or organized crime involvement.

Mid-Atlantic

The majority of districts in this region report little or no current evidence of widespread non-compliance.

The state of New Jersey, which supplies most of the gasoline for the Northeast, may also be a pocket of non-compliance, with current resources (IRS and other agencies) being inadequate to handle the problem. (The state of New Jersey has no equivalent of the "637" exemption. They collect their excise tax upon sale of gasoline by the refinery and consequently do not have the same problem. New Jersey state officials, however, have estimated the Federal excise tax loss in that state to be in the $100 million range.)

Southeast Region

While several situations in this region have the potential for development into major evasion cases, only in Florida have we seen the actual "daisy chain" type scheme in operation.

Central Region

The Detroit area has seen several investigations (state and local) relating to various kinds of motor fuel fraud and one case (local) apparently involving a "daisy chain" scheme.

Midwest

One elaborate scheme (involving an open case) has to do with a taxpayer who owns a number of retail fuel businesses and a "shell" bulk plant. The fuel is being purchased tax exempt from suppliers and billed to the bulk plant. The bulk plant then prepares phony sales invoices showing that all sales are being made to farmers and other tax exempt users, when in fact all the fuel is being shipped directly from suppliers to retail outlets. The retail outlets then sell the fuel at cut-rate prices. They maintain two sets of books (one understating sales), and then transfer currency from the unreported sales to the bulk plant. The bulk plant then uses the currency to account for the phony sales to tax exempt users and the sources of funds with which to purchase additional fuel to continue the scheme.

Southwest Region

Texas is a major producer and distributor of petroleum products and, as could be expected, has over the years produced all kinds of petroleum and oil field related activities leading to tax fraud investigations. It is believed, therefore, that while no current "daisy chain" operations are being investigated, the potential is very high. This would also apply to the other oil producing states in the Southwest.

Western Region

Recent projects (Exam) in California indicate the potential for excise tax evasion, i. e., substantial underreporting was found. Neither "daisy chain" operation nor organized crime involvement has been found in the Western Region.

B. "Five most important" conclusions:

1. CI must take a more active and visible role in the development and investigation of motor fuel excise tax cases.

2. Procedures for issuing 637 exemptions must be reviewed and modified where necessary to ensure appropriate issuances; or preferably, the exemption of distributors should be eliminated.

3. A consolidated data base of all 637 issuances, rejections, cancellations and revocations must be established to prevent related abuses.

4. Districts may not be aware of the non-compliance problem. While tax evasion, even excise tax evasion, is nothing new; recent developments and sophistication of the methods may not have come to the attention of CI. A major educational effort is planned.

5. Closer cooperation with state and local revenue departments is needed. Many of these agencies depend on fuel tax for a large portion of their income and have extensive and well trained examiners and investigators and in some cases represent an untapped source of information and assistance.

Mr. Schulze. Mr. Chapoton, would you give me a few more details on the proposal the administration would make in order to solve this problem?

Mr. Chapoton. Well, I think that we have necessarily left the proposal general in nature. The ideal is that the tax would be imposed when the gasoline is removed from the refinery.

Mr. Schulze. You say this would impose a financial burden on refiners, or smaller refiners, and that we could perhaps work out some way to alleviate that kind of pressure. Do you have any specific thoughts?

Mr. Chapoton. The only thing we could do in that regard would be to delay the timing of the payment of the tax. We could have the reports filed in a prompt fashion, and then actually have the tax payment delayed, somewhat consistent with the time that the distributor believes that he will sell the product, and therefore, be reimbursed for the amount of the tax.

Mr. Schulze. Any suggestions on a normal delay or time, 15 or 30 days?

Mr. Chapoton. I have no figures of that sort. We would propose to work with the staff of the subcommittee in determining things of that nature.

This removal from the refinery and the imposition of the tax at that time would apply to both integrated producers and nonintegrated producers, so if an integrated company removes its product, it is liable for the tax at the time it removes the product.

Mr. Schulze. Are there States on an ad valorem basis, and would this affect their taxes and/or prices at the pump?

Mr. Chapoton. I would hope it would give some impetus to adopt a procedure somewhat like that, but I don't know the impact on their own taxing systems.

Mr. Schulze. You are heading toward what appears to be the obvious solution, but there are questions to be resolved. We would like your thoughts on those questions, as we further consider how to solve this problem.

Mr. McMahon, if we don't do something about this problem, what do you see downstream? I see disaster.

Mr. McMahon. I agree with you, Mr. Schulze. There is no question that if nothing is done, the loss is not going to decline. It will inevitably increase, and as these moneys are lost to the Federal Highway Trust Fund, this is a direct loss to each State. Since the States use the money to improve the safety of their highways, this loss can be measured in lost lives, in lost employment, and it will inevitably increase.

Mr. Schulze. Do you think education about the severity of the problem on the State level would help?

Mr. McMahon. I don't know that there is anything you could teach in an educational process.

Mr. Schulze. Is there awareness?

Mr. McMahon. There is. The American Association of State Highway and Transportation Officials, an organization made up of the transportation directors of each State, have adopted a resolution recently asking Congress to take action.

They recognize that the State taxing authorities are almost powerless over Federal tax evasion. Now, New York did do something, and it was effective, and I understand a witness from New York will testify as to this. Athough they placed the point of taxation at the first importer level effective June 1, 1985, and I understand it that first year, their revenues increased over $100 million, so the States can take care of their problem that way, but the Federal 9 cents is still being stolen in New York.

Mr. SCHULZE. Don't we create incentives for evasion and avoidance, and organized crime, every time the tax is high enough to make evasion lucrative? In some instances, the tax is almost a third of the price of a gallon of gasoline. We see the same thing with cigarettes. Perhaps there is a message there for us. When we increase taxes too much, we create a greater incentive for evasion.

Mr. GUARINI. Maybe we should just limit it to 27 percent.

Mr. CHAPOTON. I think that the Treasury Department has, as the tax grows, a larger problem, but consistently, you minimize that exposure, the higher up the chain the tax is imposed.

That is why we make this recommendation, in this case, and in the case of the cigarette tax and others.

Chairman PICKLE. Mr. Guarini, do you have some questions?

Mr. GUARINI. Yes, I do so, and I insist, Mr. Chairman. Thank you.

I appreciate your testimony and the suggestions that you made, they have been positive. It seems to me a data bank is what is missing here, because that is the only way you can put any control on it.

Where would be the best place for a data bank that would be reliable so we know what the scope of the problem is, and how much tax we are supposed to collect, and would it be the Highway Authority Administration, or the IRS—where would the data bank best collect all the information we need, including that brought in from overseas also. There is a tremendous shortcoming in the way we are collecting our data, and that seems to be one of the sources of being able to control and regulate the problem.

Do you have any suggestions as to how we can develop a better data bank?

Mr. MCMAHON. The logical agency is the Department of Energy, which is presently collecting the data. The quality of the data can be substantially increased. However, the Department of Energy would also need data from the Customs Service.

Mr. GUARINI. There is discussion about the Department of Energy being phased out, which I thought was one of the wishes of the administration?

Mr. MCMAHON. As long as they are there, we might as well use them.

Mr. GUARINI. Would the Federal Highway Administration, who is making use of the moneys, have direct concern that these moneys can be collected, so you can repair your roads and bridges, be a good source for a data bank?

Mr. MCMAHON. We are a long way from having the capability of collecting the data. However, we would be primary users of the data.

Mr. GUARINI. A great part of our oil comes in from overseas. I should imagine that the U.S. Customs is supposed to monitor that part, and it has been very poorly done. Is that a correct statement?

Mr. McMahon. It may be that Customs is doing a perfectly adequate job, but the information that they have gathered may not be going to where it could do the most good.

Mr. Guarini. It doesn't seem to be such a gigantic problem, if you get down to the root of it. We just have to know how much gasoline is out there and tax it. We are, by the complexity of corporations, and by collecting our statistics inaccurately, making a mess out of the whole operation.

As for the sanctions for people who falsely deal with the 637 exemptions, I understand that nothing has been said whether or not the law is strong enough in enforcement, do we make crime worthwhile?

My understanding is that anybody who wilfully misuses a 637 exemption, which is the basis of the daisy chain, or that there is any fraud that has occurred as a result of the operation we are discussing, that the fine is no more than $5,000 or imprisonment of no more than 5 years.

That means a man is out after a year and a half, after he makes himself umpteen million dollars. There is a tremendous incentive there for the person in the public to commit a crime, and it seems to me that that sanction is very inadequate if we are going to deter people from committing the crime.

Any comment on that? I imagine you also try to get people for other violations of the statutes, RICO.

Mr. Owens. Many times, those other charges are made.

Mr. Guarini. I could beat my wife and get more than that.

Mr. Owens. Let me point out that each count carries that fine and that term of imprisonment with it. The failure to file the 720 and pay the tax would be an additional one.

Mr. Guarini. Well, is it applied that way as a matter of practice in the courts? The man that testified before us, he must have had thousands of violations, if you say each crime is separate, what was his sentence?

Mr. Owens. I am not sure.

Mr. Guarini. I assume it was a rather light one, considering the magnitude of the crime and how much he stole from the public. It is easier to take money this way than to rob a Brink's truck. A $5 million here is nothing for the underground or the underworld or a perfectly legitimate businessman to cheat the Government, the consumer?

Mr. Owens. I would agree, and I would like to see white-collar tax evasion treated the same way as robbing a bank, because that is what it is.

Mr. Guarini. The 637 fraud cases, do you have any changes in the forms or any recommendations concerning violations of your 637 exemption form?

Mr. Owens. At this time, I have no changes to recommend to you. The comment was made about the form 720, but the form 720 is the principal excise tax form, which only carries one figure. The violation occurs when it is not filed. We use that form to tie back in when we do an examination of the corporate records.

I am not proposing any changes to the 637. I am not sure what other information we could ask to be reported on there.

Mr. GUARINI. This $9 billion that we talk about, are we up to snuff in the amount of personnel we need to do the job? Do you have personnel and auditors?

Mr. OWENS. We have excise tax specialists who work predominantly in this field, as well as the criminal investigators who work on these cases. We think we have sufficient resources devoted to this particular area, and as more cases are developed, we would put more resources on it.

Mr. GUARINI. The idea is to prevent it. Do you have any strike force within the IRS? How many people do you have that deal directly with the collection of this $9 billion in the IRS?

Mr. OWENS. I don't have that figure here with me today, but adding resources will not solve the compliance problems we have discussed here today.

Mr. GUARINI. It does solve it in regard to people who fail to pay their income tax. We have ratios.

Chairman PICKLE. Mr. Owens, we are interested in knowing the number assigned as investigators who are doing audits. Submit a list of those individuals nationally, and those assigned to States. How many investigators in this field do you have assigned to Texas?

Mr. OWENS. I don't know how many people are assigned to those cases. I know the number of cases.

Chairman PICKLE. Please give us that.

[The information follows:]

FY1985 RESOURCE SUMMARY

EXAMINATION EXCISE TAX PROGRAM

IRS District	Examiners	Returns
ALBANY	2	378
AUGUSTA	1	466
BOSTON	6	1020
BROOKLYN	6	1128
BUFFALO	13	1429
BURLINGTON	1	72
HARTFORD	3	519
MANHATTAN	4	364
PORTSMOUTH	1	283
PROVIDENCE	1	56
BALTIMORE	2	873
NEWARK	3	577
PHILADELPHIA	3	651
PITTSBURG	2	1014
RICHMOND	2	383
WILMINGTON	1	67
FOD	1	24
ATLANTA	2	467
BIRMINGHAM	1	434
COLUMBIA	1	203
GREENSBORO	3	945
JACKSON	1	763
JACKSONVILLE	5	2181
LITTLE ROCK	2	323
NASHVILLE	3	1781
NEW ORLEANS	2	863
CINCINNATI	4	872
CLEVELAND	10	1429
DETROIT	9	1806
INDIANAPOLIS	3	1302
LOUISVILLE	1	150
PARKERSBURG	1	326
ABERDEEN	1	111
CHICAGO	9	735
DES MOINES	2	390
FARGO	1	145
HELENA	1	272
MILWAUKEE	5	1295
OMAHA	1	301
SPRINGFIELD	2	554
ST. LOUIS	4	635
ST. PAUL	3	254
ALBUQUERQUE	1	308
AUSTIN	3	1109
CHEYENNE	1	79
DALLAS	8	1364
DENVER	6	1109
HOUSTON	7	1546
OKLAHOMA CITY	5	2216
PHOENIX	1	483
SALY LAKE CITY	1	161
WICHITA	1	1287
ANCHORAGE	1	243
BOISE	1	292
HONOLULU	1	196
LAGUNA NIGUEL	5	786
LAS VEGAS	1	375
LOS ANGELES	6	1496
PORTLAND	2	1037
SACRAMENTO	2	569
SAN FRANCISCO	2	696
SAN JOSE	2	842
SEATTLE	3	1028

Chairman PICKLE. Gentlemen, thank you for your testimony. Mr. Chapoton thinks it might be lower. We would ask that you submit to us your recommendation. Mr. Chapoton has given us some specific suggestions, things we might do.

Mr. Owens, I hope you would work in coordination with him because between Treasury and the IRS, you probably ought to give us some specific recommendations. The data collection may be assigned to the Department of Energy but we need to nail down these specific things.

Mr. GUARINI. Mr. Chairman, may I ask one further clarification, with your permission?

We talked about, Mr. Chapoton, the amount of money that is lost as a result of excise gasoline tax fraud.

Does that amount of money that you estimate include the income tax that would be lost also through these operations? Is that a total loss to the United States or are you confining the figures that you have given us to the excise fraud?

Mr. CHAPOTON. My figures relate solely to the excise tax portion.

Mr. GUARINI. Are there additional moneys as a result of violations that we have discussed this morning that would be lost in terms of income tax?

Mr. CHAPOTON. We have not attempted to quantify that. That is a different problem.

Mr. GUARINI. Does the procedure allow or go over into the question of further losses from the income tax itself?

Mr. CHAPOTON. That is very difficult to say because that relates more to how the criminal element reports its ill-gotten gains and whether some are not truly criminals but merely avoiding some element of excise tax and still reporting the difference. If they are filing proper income tax returns that show that they made this profit, then there would not be an income tax loss.

Mr. GUARINI. Bootleg gas, no record of how much gas would be sold where companies would not be making any record whatsoever, so therefore, there would be further losses above the excise tax loss you testified to which would include an underground economy involving income tax losses, am I correct in that, Mr. Owens?

Mr. OWENS. My reaction is, it is more likely than not that you are correct. I have no basis except my own past experience and judgment: where you see one type of tax evasion, there is usually others there.

Mr. GUARINI. Thank you, sir.

Chairman PICKLE. Thank you, gentlemen, very much. We hope the word goes out today that Justice, Treasury, and the Internal Revenue Service are going after gasoline cheaters and evaders, that their free time is over, that you are going to zero in on them. To the extent we can help you attack this problem, we ask for your cooperation.

Thank you very much.

[The following was subsequently received:]

DEPARTMENT OF TRANSPORTATION
FEDERAL HIGHWAY ADMINISTRATION
WASHINGTON, D.C. 20590

OFFICE OF
THE ADMINISTRATOR

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July 17, 1986

IN REPLY REFER TO:

The Honorable James A. Baker, III
Secretary of the Treasury
Washington, D.C. 20220

Dear Secretary Baker:

I want to thank you for the extremely effective help the Treasury Department has given in attacking the problem of Federal excise tax evasion. The functions of the Federal Highway Administration (FHWA) are limited to prudently administering the Highway Trust Fund after the tax has been collected. We lack the experience, expertise and authority of the Treasury Department in determining the most effective system of tax administration and collection. With that in mind, I would like to report recent developments which are at best, extremely troubling. In view of the fact that the Ways and Means Committee has scheduled consideration of highway user taxes for next Tuesday and Wednesday, remedial action, if it is to be taken, should be taken now.

As you know, the Ways and Means Subcommittee on Oversight held hearings on July 15th. Deputy Assistant Secretary O. Donaldson Chapoton's testimony was very well prepared and extremely persuasive that gas tax evasion is a substantial national problem which calls for legislative correction. In addition to Mr. Chapoton and Mr. James I. Owens of the IRS, the Subcommittee heard testimony from the Department of Justice and Federal Bureau of Investigation, Tax Commissioners from California, New York and Florida, and the Executive Secretary of the National Association of Tax Administrators. The gist of the testimony was that the state and federal governments are suffering astronomical losses through gas tax evasion. The Subcommittee's mystery witness, a former mobster in the witness protection program, testified that he had operated a gasoline distribution business in conjunction with an organized crime family in four states. He testified that his profits on evaded taxes were $8 million a week. This, of course, is 416 million dollars a year which he testified continued for two or three years.

The state and federal witnesses were unanimous in their recommendation that the tax be imposed at the highest level on the distribution chain, that is, at the refinery or first importer level. This recommendation would result in a reduction in the number of taxpayers from something in the neighborhood of 8,000 to about 220. The Internal Revenue Service testified that, even with vastly increased resources, stepped-up enforcement would not solve the evasion problem which stems from the multiplicity of taxable entities.

The Subcommittee also heard testimony from three trade associations representing gasoline marketers. One association testified that the problem did not exist because the witness had not encountered it in his market area. Another testified that while it may exist it had not been proven, and the proposed legislative solution would work an undue hardship on industry members. The third marketing witness testified that evasion does exist on a large scale but can best be corrected by increased enforcement efforts. All three of the trade associations were vigorous in their attacks on the Internal Revenue Service and the Department of Justice which they said had been inept and ineffective in carrying out their enforcement and prosecution responsibilities.

There are two major obvious weaknesses in the opposition to moving the tax to the refinery level. First, as pointed out by Treasury and the IRS, the structure established by present law makes enforcement by increased audits a practical impossibility. State and federal tax accounts for between 20 and 30 percent of the price of gas sold today. National tax revenues on gasoline amounts to approximately $20 billion dollars a year. This is too large a target to be ignored by organized as well as ordinary evaders. The number of taxpayers simply must be reduced.

The second weakness in the marketers' presentation was their argument that they are entitled to the cost free use of the cash produced by the tax intended for the Highway Trust Fund, even though permitting them the use of the so called float results in a substantial demonstrable loss to the Trust Fund. We cannot concede any such entitlement.

The marketers also claim that the 1959 amendment to the Internal Revenue Code which resulted in their being included in the definition of tax exempt producers was intended to correct a competitive disadvantage between the independent marketer and the integrated oil company which did not have to remit the tax until it had a taxable sale at the retail level. The marketers argued that our proposed legislative change would reestablish that competitive imbalance. This argument ignores technological and market changes which have occurred over the last 27 years. We have been advised by major oil companies and representatives of the American Petroleum Institute that the integrated majors have no objection to remitting the tax when it leaves the refinery even though they retain ownership of the product. Many do so now as a matter of course. Market conditions require rapid turnover of inventory; tax-paid product is not going to be kept in storage facilities by either the majors or the independent marketers. The marketers argued that they maintain substantial storage facilities in which product may be kept for several weeks before sale. Thus, they claim the marketer would be paying tax on gasoline he may not sell until considerably after the time he is required to pay the tax. This argument is hardly credible. To the extent it is true, the problem is the result of unwise business decisions which must not be permitted to result in a benefit to criminals and a loss to the taxpayer.

I believe the Subcommittee was truly astounded by the enormous loss of gas tax revenues to organized crime as well as ordinary evaders. The members were interested in knowing where the evasion scheme was operating. Testimony indicated it was known to be functioning in 12 to 14 states. However, the FHWA witness pointed out that no matter where it is operating, the effect is felt in every state through the reduction in the amount of Federal-aid highway funds available for apportionment. Chairman Pickle was surprised to learn that if, as the testimony indicated, federal losses in one year amounted to 1 billion dollars, the resulting loss in federal highway funds to Texas would be $72 million.

The Federal-aid Highway Program cannot bear the continuing hemorrhage of funds to tax evaders. Under today's budget restraints, although we are able to meet the Nation's critical highway and bridge infrastructure needs, we are operating on an extremely thin margin. The Ways and Means Committee will take up the revenue portion of the highway bill on the 22nd of this month. I have enclosed a draft of some remedial legislative language which I would greatly appreciate your considering as a starting point for the Treasury Department's recommendation. My Chief Counsel will be happy to work with your staff.

Again, you have my heartfelt thanks for your continuing support.

Sincerely yours,

R.A. Barnhart

R. A. Barnhart
Federal Highway Administrator

Enclosure

cc: Mr. O. Donaldson Chapoton
Deputy Assistant Secretary (Tax Policy)

A BILL

To secure the full payment of the Federal excise taxes on gasoline.

Be in enacted by the Senate and House of Representatives of the United States of America in Congress Assembled.

Sec. 1. Subsection (a) of section 4081 of Title 26, U.S. Code, is revised to read as follows:

(a) In general.--There is hereby imposed on gasoline produced or imported by the first producer or importer thereof, a tax of 9 cents a gallon.

Sec. 2. Subsection (a) of section 4082 of Title 26, U.S. Code is revised to read as follows:

(a) Producer.--As used in this subpart, the term "producer" means only a refiner.

Sec. 3. Subsection (c) of section 4082 of Title 26, U.S. Code is amended by striking therefrom the words, "sold to him free of tax, or produced or imported by him, such use shall for the purposes of this chapter be considered a sale.", and inserting in lieu thereof: "produced or imported by him, such use shall be taxable at the time of use."

Sec. 4. Subsections (d) and (e) of section 4082 of Title 267, U.S. Code, are repealed.

Sec. 5. Section 4083 of Title 26, U.S. Code, is revised to read as follows:

§4083. Gasoline tax regulations. The Secretary may prescribe regulations concerning the time, place and manner of payment of tax, including allowance for product loss in accordance with national standards, in the interest of equitable tax treatment among gasoline industry members.

(Technicals, change of chapter analysis, etc.)

DEPARTMENT OF TRANSPORTATION
FEDERAL HIGHWAY ADMINISTRATION
WASHINGTON, D.C. 20590

OFFICE OF
THE ADMINISTRATOR

AUG [illegible] 1986

August 22, 1986
IN REPLY REFER TO

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Ways and Means
Subcommittee on Oversight

The Honorable J. J. Pickle
Chairman, Subcommittee on Oversight
Committee on Ways and Means
House of Representatives
Washington, D.C. 20515

Dear Mr. Pickle:

Enclosed are Federal Highway Administration questions and answers requested in your letter dated July 22, 1986. The questions and answers are for the record of the hearing held July 15, 1986, to examine compliance with the federal excise tax on the sale of gasoline. Please advise us if you need further assistance.

Sincerely yours,

Robert E. Farris
Deputy Administrator

Enclosure

7/30/86
Question No. 1

Q's and A's for Record
Hearing to Examine Compliance with the Federal Tax on the Sale of Gasoline

Subcommittee on Oversight

Committee on Ways and Means
July 15, 1986

Question: How many gallons of gasoline are sold domestically each year? How many gallons of gasoline are imported each year? How many gallons of gasoline are taxed each year? Does anyone monitor the shipment of gasoline within the United States?

Answer: Based on data reported to FHWA by the State Motor Fuel Tax Agencies, gross gallons reported by wholesale distributors (including gasohol and gallons sold exempt from taxation) were as follows:

C.Y. 1984	106,283 million gallons
C.Y. 1985	109,953 million gallons

Data from the Petroleum Supply Division, Energy Information Administration, U.S. Department of Energy, indicate the following quantities of imports, including blending components:

C.Y 1984	5,856 million gallons
C.Y. 1985	6,688 million gallons

State reports indicate that there were 104,154 million gallons of taxed gasoline in 1984. State totals for calendar year 1985 are not yet available. The 1985 IRS collections indicate that 101,474 million gallons of gasoline were taxed in 1985.

It should be noted that this information is not appropriate for making estimates of evasion. Due to the magnitude of gasoline sold each year, over 100 billion gallons, the data collected by DOT, DOE, and Treasury are not sensitive enough to show possible levels of evasion.

Within the Energy Information Administration, Department of Energy, there are 2 units that collect information on movements of gasoline within the United States, but at different levels.

1. The Petroleum Supply Division, collects information on shipments by producers, importers, and pipeline companies, at a Petroleum Administrative District level (each District contains several States).

2. The Petroleum Marketing Division collects information on "First Sales into States for Consumption." Reporting entities are producers, importers, and a few large wholesalers.

Question No.2

Question:	What information has the FHWA received about the scope and nature of gasoline excise tax evasion from state highway administrators? From state tax administrators?
Answer:	FHWA has received little information from state highway administrators who, generally, have been unaware of tax evasion, since, as in the FHWA, they have no function in the tax collection area. When the problem came to FHWA's attention, we made sure the state highway administrators were made aware of the possible drain on their source of highway revenues. They, in turn, have begun to demand some answers from their counterparts in the revenue departments.

Tax administrators, through their national association, have been aware of evasion of taxes on diesel fuel for some time. They generally know the nature of this problem, and have been struggling to define the scope and devise remedies. The picture with regard to gasoline tax evasion is somewhat different.

New York, for example, was very slow in recognizing that a gasoline problem existed, but when it did, it acted decisively. Since adopting its first importer law last year, New York reports that its revenues from gasoline taxes have increased by 23 percent, which is confirmed in FHWA figures.

Some Florida tax officials do not believe that an extensive problem exists, even though $40 million in revenue has been reported lost. Florida enforcement officials, however, acknowledge that evasion is substantial and fairly widespread. They are pursuing investigations and prosecutions quite aggressively. In fact, Florida state enforcement officials have developed an investigative model, which they believe has been very helpful to them in detecting the likelihood of evasion.

Because of the differences among the tax collection procedures in the various states, many tax administrators rely on a belief that the substantial evasion problem in New York was unique. Others frankly admit that a problem may exist in their states, but they have difficulty detecting it.

We have learned recently that the State of Arkansas is investigating major deficiencies in tax collection procedures. Early estimates indicate the state may be losing as much as 16 percent of its gas tax revenues through evasion.

Some state tax administrators believe that they have no significant problems since they already have a first importer law. However, the federal gasoline tax in those states may not be collected from the first importer. California, for instance, reports that because of its first importer law, the evasion of gasoline tax is minimal. Evasion of state sales tax on gasoline, however, has presented a considerable problem. We frankly don't know whether the federal gas tax is being evaded in that instance.

Similarly in Michigan, upon discovery of significant evasion of the sales tax on gasoline, a first importer policy was adopted. After the first year, the state realized substantial increases in revenues. The state is now looking at the possibility that motor fuel taxes were also being evaded. It is entirely possible, if not likely, that the federal gasoline tax is also being evaded.

Recently, the National Association of Tax Administrators joined with the Internal Revenue Service in an effort to detect the spread of the gasoline tax evasion problem. Six states have been selected, and sample audits of selected taxpayers are being conducted by both state and federal auditors separately. The study will be concluded later this year and should indicate whether evasion is occurring in those states.

Question No.3

Question: What firsthand information does the FHWA have indicating that the problem of gasoline excise tax evasion is occurring in states other than New York and Florida?

Answer: FHWA has no firsthand information that the problem of gasoline tax evasion is occurring in states other than New York and Florida. FHWA has no tax collection function, and no investigative responsibilities in this area. When the agency became aware of an evasion problem, we immediately discussed our concerns with the Department of Justice, the Treasury Department, and the Internal Revenue Service. FHWA lacks the experience, expertise and authority to undertake its own investigation and must rely on these agencies for firsthand information.

The Organized Crime Strike Force in New York, which includes agents from the FBI and IRS, as well as the U.S. Attorney's Office, was very helpful. They provided information on current investigations and demonstrated the existence of current evasion schemes and the very obvious potential for additional large scale evasion. The investigations in New York and Florida were initiated because of the involvement of organized crime in some of the tax evasion schemes. Their investigations indicate that evasion is widespread and is likely taking place in at least 12 other states. Investigations have not been opened in these states as yet for reasons given by DOJ and the FBI at the hearings.

The Internal Revenue Service has taken steps to identify further the scope of the evasion problem. Early indications are that evasion is occurring and that it is not limited to organized crime influence. The Internal Revenue Service has also acknowledged that the tax collection system as presently constituted invites evasion. The investigations and prosecutions in New York and Florida have more than confirmed this.

At FHWA, we are very concerned about the actual and potential loss of revenue to the Highway Trust Fund, and are not at all confident that stepped up enforcement under the present structure will be very effective in solving the problem. We gathered information, necessarily second-and-third-hand, to satisfy ourselves that some effective measures were being undertaken to stop the drain on revenue. We are not satisfied, and believe a legislative change is needed.

Question No. 4

Question: What could the Federal Highway Administration (FHWA) do to improve Federal gasoline excise tax collections or compliance with the law? What could IRS do? Justice? Customs?

Answer: The FHWA has no direct responsibility for enforcement and collection of the Federal gasoline excise tax. These are solely within the purview of the Internal Revenue Service (IRS). Our responsibility is to manage the Federal-aid highway program authorized by Congress.

The IRS is presently working with Justice to identify, try, and convict Federal fuel tax evaders. Because of the nature of the more significant evasion activity, principally creative bookkeeping using tax-exempt transfers to conceal nonpayment of the tax, we are convinced that increased routine IRS audits will do little to stop the evasion. For this reason, we have proposed a change in the legislation that governs the collection of the tax. Basically, our proposal would eliminate tax free sales of gasoline and require the tax to be paid at the refinery level or on first import. This would greatly reduce the number of taxpayers, from approximately 8,000 to between 200 and 300, thus substantially reducing the opportunity for evasion.

Question No. 5

Question: Are there known compliance and enforcement problem areas with regard to the other highway-related Federal excise taxes?

Answer: For the past few years, particularly with the increase in diesel fuel taxes, members of the National Association of Tax Administrators have expressed concern over apparent evasion of State diesel fuel tax. They have suggested that a similar problem exists for the Federal tax and have been working with the IRS on the problem. Diesel fuel, however, presents a unique problem over that of gasoline in that tax-free home heating oil can be readily substituted. This prevents collecting the tax at the refinery level and requires both State and Federal highway use taxes to be collected at the retail level.

We estimate that the dollar magnitude of evasion is somewhat lower than that of gasoline because the quantity of diesel fuel consumed by highway users is nearly one-fifth that of gasoline. Evasion as a percentage of total diesel fuel may be higher than for gasoline, however.

Prior to the requirement for proof-of-payment of the heavy vehicle use tax, implemented by the Surface Transportation Assistance Act of 1982, it was believed that evasion of this tax was fairly high. Under the proof-of-payment requirements, truck vehicle licenses cannot be obtained from the State without documentation that the Federal heavy vehicle use tax has been paid.

We are not aware of any compliance or enforcement problems related to the vehicle and tire sales taxes which make up the remaining Federal highway user fees.

Chairman **Pickle**. The next panel consists of Robert Nunes, Roderick Chu, Stephen Barger, and Leon Rothenberg. If you four gentlemen will come forward.

I want to say that the committee will go right on through. We have this panel and one other panel to be heard from and we will try to move as quickly as possible. We are sorry it has taken longer than anticipated.

We will first hear from Robert Nunes.

Mr. **Nunes**. I will summarize my written report.

Chairman **Pickle**. We have your statement and all the other statements will be included in their entirety.

STATEMENT OF ROBERT NUNES, CHIEF OF FIELD OPERATIONS, CALIFORNIA STATE BOARD OF EQUALIZATION

Mr. **Nunes**. California imposes two excise taxes on gasoline, a motor vehicle fuel tax at 9 cents a gallon and a sales tax on the retail sale of gasoline. As far as we know we have no major tax evasion problems with respect to the motor vehicle fuel license tax, but some significant problems in the area of sales tax. We believe that the root cause of that problem is the fact that the tax is collected at the end of the distribution chain rather than at the beginning.

At this point, transactions are on a cash basis and often difficult to trace. The problem is not limited to any specific geographic area within the State, but occurs in all metropolitan areas and along the well traveled highways of the State. In many cases we believe that service station operators share information and may be part of an organized scheme.

Some groups of operators frequently exchange locations with each other by buying and selling each other's stations. We also have found many cases where account numbers have been changed through changes of partnership or incorporation or changes to sole proprietorships. In some cases these tax evaders also operate on a wholesale basis and have a number of retail outlets.

We have had a two-pronged approach to try to deal with this problem. First on July 1 of this year, California enacted a prepayment scheme for the prepayment of sales tax on gasoline and collects 4 cents a gallon at the distributor level which generally is the oil refiner or major importer.

Second, we have increased enforcement. We have made an effort to identify through review of our files people who we believe may be under reporting the tax. We have contacted every supplier of gasoline to California retailers, and have accumulated information with respect to the distributions to these retail outlets. This information has recently been sent to our field offices, and we are in the process now of auditing these firms.

We have been involved in a joint audit program with the IRS as mentioned by others, and the diesel portion of the program has been recently completed. It involved the audit of about 5 operators, 5 by the State, 5 by the IRS, and these were very productive audits. We are moving into doing some joint audits in the area of gasoline tax. I have no information at this time with respect to the effect of that program.

We estimate, based on this initial survey we have made of specific operators, that we may be losing as much as $30 to $50 million annually in sales tax revenue. Some of these people would not be involved in collection of the Federal excise tax but many would. We have no reason to believe that the people who are cheating us on California sales tax would be reporting the Federal excise tax. That is about the best estimate we can come up with with respect to revenue losses in the State of California.

As far as recommendations go, most people have already expressed what needs to be done and I agree. The tax must be collected as early in the distribution scheme as possible.

Second, there must be increased enforcement at the Federal level. The States have increased their enforcement and through an exchange of information we can get better coverage and deal with the tax cheaters.

Finally, we need to make sure information is readily available to the tax agencies. I have heard complaints by some tax administrators of inability to get information from some Federal agencies. We have not had this problem. We should have a free flow of information with respect to the importation and distribution of fuel.

[The prepared statement follows:]

Testimony
of
Robert Nunes
Chief of Field Operations
California State Board of Equalization

California's Method of Collecting Gasoline Excise Taxes

California imposes two excise taxes on gasoline. The Motor Vehicle Fuel Tax which is a nine cents per gallon tax on the distribution of gasoline and a sales tax, ranging from 6% to 7% depending on the local tax rate, on retail sales of gasoline.

The Motor Vehicle Fuel Tax is collected on the first distribution (sale or use) in California. There is a provision to allow tax-free sales between distributors who meet certain financial requirements. Currently, there are 27 distributors qualified to acquire tax-free fuels. All of these qualified firms operate refineries in California.

The sales tax is imposed at the retail level at the time the gasoline is sold.

Scope of Tax Evasion

California has no known major tax evasion problems in the administration of the Motor Vehicle Fuel Tax. Our evasion problems have been in the collection of the sales tax. Our experience in this area has been similar to the problems some of the Eastern states have had with the Motor Vehicle Fuel Tax evasion. We believe the root cause is the imposition of the tax at the end of the distribution chain. At this point, many transactions are on a cash basis and it is often difficult to trace the acquisition and disposition of the fuel.

We have found that there is a very large, multimillion dollar, tax evasion problem in California from unreported sales of gasoline and other fuels. Indications are that California loses many millions of dollars annually due to tax evasion by retail service station operators.

In the past, our audit program has uncovered sporadic cases of fraudulent underreporting by retailers of gasoline. In the last few years, however, more and more instances of tax fraud have been found. Our current formalized statewide program to detect fraudulent underreporting has shown that the problem has grown to serious proportions.

As one would expect, the most cases of fraudulent underreporting have been found in Southern California, due to its very large gas consumption. The problem is not limited to any geographic region but has been found wherever there are large population centers and along well traveled highways throughout the state.

It appears that service station operators, in many instances, share information and some may be part of an organized scheme. These operators are apparently aware that they reduce the likelihood of being audited if they operate a service station for a relatively short time. Therefore, it appears that some groups of operators frequently exchange locations with each other by "selling" and "buying" each others' stations. We have also found many cases in which changes of accounts are due to changing partners or due to changing the types of ownership between sole owner, partnership, or corporation. In many cases, names of owners are spelled with variations or first, middle and last names are switched. These persons also use multiple suppliers in some cases, but their records only show purchases from one or two of the suppliers used.

In some cases, known tax evaders are wholesale suppliers in addition to having retail outlets. Many of the persons involved have multiple locations and report substantial tax, but when the amount per station is analyzed, reported amounts are dramatically low.

Other service station operators who fraudulently underreport buy only from one supplier, stay in business for extended periods, and simply purposefully underreport their taxes.

It appears that many persons involved with underreporting tax on gasoline are also involved in other businesses. We are currently taking a look at these other types of businesses to develop future enforcement programs.

Action to Curtail Evasion

California has a two-prong approach to dealing with the evasion problem.

Effective July 1, 1986, California law was amended to require the pre-collection of a four cents per gallon sales tax at the time the gasoline is subject to the Motor Vehicle Fuel License Tax. Each distributor is required to pre-collect tax of four cents per gallon and issue an invoice to the purchaser. Each subsequent seller must collect the four cents per gallon and must retain a copy of the invoice in order to claim a credit for the prepayment on the return. The retailer reports the full tax due and claims the four cents per gallon prepayment which must be supported by the invoice.

Since this law has only recently been placed in effect, we do not have any experience as to its benefits and its problems. However, we believe that the overall benefit will far outweigh some of the costs involved in this program.

Our other enforcement effort deals with periods prior to July 1, 1986. Based on certain criteria, we selected gasoline retailers whose volume of reported sales indicates a possibility that not all of the sales tax due has been paid. We then contacted every supplier of gasoline to California retailers to obtain a record of purchases by these retailers. These suppliers were located both within and without the state.

Using a personal computer this information has been accumulated and sorted by retailer. Recently, this information has been sent to district offices for investigation of the retailers involved.

In addition we have received information from people in the retail and wholesale gasoline business of possible tax evasion by other retailers. These leads have been acted upon, and to date we have issued tax determinations in excess of $26 million.

State-Federal Cooperation

California is one of the states cooperating in the IRS/NATA Joint Audit program. We have completed the initial phase of the program which involved the taxation of diesel fuel.

The diesel fuel tax joint audit program indicated substantial underpayments of federal tax. Some of it was the result of ignorance on the part of taxpayers while in other cases deliberate tax evasion was the problem.

From the state's viewpoint the program also has been effective and has allowed us to take advantage of the information obtained from Federal audits.

We have arranged for an exchange of future diesel fuel tax audit reports between the two agencies.

Additionally, California furnishes the IRS a list of taxpayers registered for diesel tax in California and the amounts reported. The IRS, in turn, has furnished California with a list of gasohol blenders which is of use to us since gasohol does not enjoy a gasoline tax exemption in California.

In the future, we hope to obtain information on the importation of gasoline. The details of this exchange of information will be handled in conjunction with the current gasoline tax cooperative effort.

Further study as to additional information to be furnished on gasoline tax will be made in conjunction with our gasoline tax cooperative program. Since the incident of tax at the state level is early in the distribution system while the federal tax may be imposed near the end of the distribution system, the exchange of gasoline tax information may not be of much value. On the other hand, the imposition of the California sales tax in some cases occurs at the same time as the imposition of the Federal excise tax. An exchange of information with IRS on sales at this point in the distribution system may be very effective.

The gasoline tax phase of the cooperative program is in its early stages and we do not have anything to report on its progress. However, our experience in sales tax evasion related to sales of gasoline leads us to believe that there is significant underreporting of Federal gasoline tax. As we understand it, any retailer of fuel who operates ten or more stations may acquire fuel ex-tax and be responsible for reporting the federal excise tax. There is no reason to believe that the people who were cheating on California sales tax were reporting federal excise tax. On the contrary, these transactions were largely "off-the-books".

Estimates of Annual Federal Revenue Loss

Since our cooperative program with the IRS on gasoline tax is in its early stages, we do not have any hard information on the scope of the problem.

We estimate that the annual loss from sales tax evasion may run as high as $30-50 million dollars annually. This is based on the preliminary information obtained from the matching process described earlier. Some of the people involved in sales tax evasion are not qualified to acquire gasoline without payment of the Federal Excise Tax while some are qualified. On the other hand, some of the wholesalers who participate in these tax evasion schemes by selling "off-the-books" to the retailer are not subject to California Sales Tax but do qualify to collect the Federal Excise Tax. Considering all of these factors, it is not inconceivable that the Federal tax evasion in the State of California is equal to California's tax evasion problem in sales tax.

Recommendations for Federal Legislation

We have three suggestions for legislative and administrative changes to improve gasoline excise tax compliance.

First, the tax should be collected as early in the distribution chain as possible. Ideally it would be upon manufacture or importation. This may create some problems for the industry particulary with respect to cash flow. If this is not feasible, tax should be imposed on the first sale of the gasoline.

Second, we believe that a strong audit presence is necessary to insure compliance. No matter what method of taxation is adopted, there will be people who will continue to develop new methods to evade taxes. A strong audit program can act as a deterrent. If the Federal government will support a strong program, the presence of Federal auditors will assist the States' in their enforcement programs through an exchange of information. Likewise, the States will support the Federal governments program by supplying the IRS information from State audits. Active programs by both the States and IRS will greatly increase the visibility of the taxing authorities and act as a significant deterrent to tax evasion.

Third, any impediments to the exchange of information between the States and the IRS should be removed. In California, we have not had any serious problems in this regard. However, I have heard some state tax administrators complain about the difficulty in obtaining information from some Federal agencies. The IRS has been assisting the States in obtaining the necessary information from Customs, Department of Commerce, Corp of Engineers and the Coast Guard. Whether this action will alleviate the problem, I am not certain. However, a strong State enforcement program will enhance compliance at the Federal level. Accordingly, every Federal department should cooperate directly with the States to provide them with their legimate information needs.

Chairman **Pickle**. Thank you for your testimony. You have made three good suggestions.

Now we will hear from Mr. Chu.

STATEMENT OF RODERICK G.W. CHU, COMMISSIONER, DEPARTMENT OF TAXATION AND FINANCE, STATE OF NEW YORK

Mr. **Chu**. I do appreciate the invitation to be here with you today. New York's experience in combating gasoline tax evasion may be useful in your efforts to address Federal excise tax evasion. Mr. Ryan covered the structure of New York State's taxes in an earlier question, but prior to 1985 the motor fuel and sales taxes were imposed upon sales by distributors. However, sales from one distributor to another were tax exempt. This led to evasion, called the daisy chain. To a lesser degree there was also the direct physical bootlegging of products across State lines.

To address these problems, in November 1983, Governor Cuomo established a joint government/industry task force on the administration of taxes on the petroleum industry. I can't emphasize enough how important it was to bring industry representatives, with their special expertise, into the process. They were so concerned, they commissioned a study of the problem which estimated the annual loss in sales and motor fuel tax to New York State in 1985 dollars at between $173 and $254 million.

In 1985, as a result of the task force's work, industry lobbying, and a general toughening of tax enforcement, the State legislature passed what we call the first import bill. That bill moved the incidence of tax further up the distribution chain to the point where the fuel is first imported into the State. It also eliminated tax-free interdistributor sales.

Since the new law took effect in June 1985, collections of both motor fuel tax and sales tax for gasoline have risen 23 percent over comparable periods in 1984. More than $123 million in additional State and local tax revenue has been collected during the first 9 months.

However, no sooner had the new law gone into effect, than organized crime was looking for loopholes and new schemes. They have a great stake in tax evasion and massive resources—computers, high-priced attorneys, thugs, and nearly unlimited capital.

Within 6 months of the new law, and despite a number of administrative and enforcement actions involving stricter bonding requirements, review of distributor licenses and increased surveillance, we became convinced we had to do more. We have just secured passage of a first import enforcement enhancement law which will shutdown some of the new schemes and wrinkles which have surfaced, such as the buy out/bust out scheme and increased physical bootlegging.

This most recent enhancement of our enforcement capabilities will help, but the battle is far from over. This problem demands Federal attention. Increased Federal involvement would not only complement State efforts to combat evasion of State taxes; it would also raise additional Federal revenues from improved compliance with Federal taxes on motor fuel.

Just 2 weeks ago, our agents interdicted 900,000 gallons of gasoline imported with a revoked license for a distributorship which had just been sold. This seizure alone doubtless represents a loss of $81,000 in Federal gasoline excise tax.

If the Federal Government, following New York's lead, were to adopt improved compliance measures, it would gain more than $1 billion annually in increased Federal revenues. That is a conservative estimate; I submit the gain could be much higher. Our industry advisers and our own investigators are reporting more and more evidence of schemes where all State taxes are being paid while the crooks turn their attention exclusively to evading Federal taxes.

To stem this tide of Federal tax evasion, I suggest that Federal involvement should take several forms:

First, enactment of a strict Federal "first import" law which moves the incidence of the Federal gasoline excise tax up to the point of refining or importation into the country and eliminates tax-free sales between importers, producers, or wholesalers.

Second, the imposition of basic Federal licensing and reporting requirements including: (*a*) central national registration for importers and refiners; (*b*) minimum licensing and bonding requirements; (*c*) monthly as opposed to quarterly filing requirements; and (*d*) a detailed motor fuel excise tax return.

Third, a strengthened commitment to Federal enforcement. This enforcement, wherever possible, should expand upon the cooperative Federal/State approach that current NATA/IRA projects utilize. It also necessitates adequate IRS staffing. Proper enforcement requires resources.

Fourth, the passage of H.R. 1605 making gasoline bootlegging a RICO crime. I applaud the passage of H.R. 6, a related bill which will require the Army Corps of Engineers to share information on barge traffic with State tax officials.

Fifth, development of a joint Federal/State motor fuel tracking system. States such as New York, New Jersey, and Florida are inundated with interstate gasoline shipments. Sixty percent of all traffic in the Port of New York involves petroleum products. While we are exploring our own verification code tracking system, the best tracking system would be national in scope.

Sixth, better coordination between the IRS, U.S. Customs, and the Environmental Protection Agency to address the twin problems of tax evasion and motor fuel adulteration. Curiously, an EPA sweep of New York gas stations this February found that the incidence of fuel adulteration—which had been uncommonly high—has dropped drastically since the implementation of our first import law.

Seventh, attention to the problems associated with physical international borders such as those with Canada, and to the special problems connected with Indian reservations.

Some of the recommendations I have made would place additional burdens on the petroleum industry in the form of increased paperwork and the cash-flow problem of up fronting the tax. However, I am confident that most industry representatives would gladly shoulder those burdens if it meant the elimination of organized crime and tax evasion from the petroleum industry, enabling law-abiding firms to compete fairly with one another.

In the era of high Federal deficits, there is no excuse for allowing organized crime to line its pockets at the expense of the Federal and State Governments. New York is prepared to assist your efforts in every way possible.

[The prepared statement and attachment follow:]

SUBMITTED BY: RODERICK G. W. CHU
COMMISSIONER OF NEW YORK STATE
DEPARTMENT OF TAXATION AND FINANCE

Chairman Pickle, Members of the Subcommittee.

Thank you for inviting me here today. I think New York's experience combatting gasoline tax evasion will prove very instructive in your efforts to address federal gasoline excise tax evasion.

New York imposes three major taxes on petroleum products and businesses: a franchise gross receipts tax at the rate of 2 3/4%; a motor fuel tax at the rate of 8 cents per gallon of gasoline; and our state and local sales tax which varies from a low of 4% to a high 8 1/4% depending on the local sales tax rate.

Prior to 1982, sales tax was collected and remitted by retail service stations while the motor fuel tax was triggered when a registered gasoline distributor sold to a nonregistered distributor or retailer. In New York, anyone who imports gasoline into the state or who refines in the state is required to register as a motor fuel distributor. No minimum amount of importation is required. In 1982, because of the recognized problem with tax evasion, the responsibility for collecting sales tax was moved up the supply chain to the same distributor level as the motor fuel tax. This, coupled with allowing interdistributor tax-free sales, resulted in what one state legislator subsequently termed going "from petit larceny to grand larceny."

The chief form of evasion, a scheme crafted and controlled by organized crime, was the "daisy chain." This scheme used a succession of rapid "tax free" then "tax paid" paper transactions to temporarily hide who was marking the invoice "taxes paid," passing the product on at the higher price, but never paying the taxes due. To a lesser degree, there was also the direct physical bootlegging of product across state lines.

To address these problems, in November 1983, Governor Cuomo established a Joint Government/Industry Task Force on the Administration of Taxes on the Petroleum Industry. I have provided the subcommittee with copies of the Task Force's reports. They contain more detailed information on the evasion schemes employed.

I can't emphasize enough how important it was to bring industry representatives, with their special expertise, into the process. The industry was so concerned with the disruption of the petroleum business caused by tax evasion that the New York State Petroleum Council commissioned an independent study of the tax evasion issue. That study by National Economic Research Associates estimated the annual loss in sales and motor fuel taxes to New York State in 1985 dollars to be between $173 million and $254 million. A copy of the study has been provided to the Subcommittee.

In 1985, as a result of the Task Force's work, industry lobbying, and a general toughening of tax enforcement, our Legislature passed what we call the First Import Bill. That bill moved the incidence of tax further up the distribution chain to the point where the fuel is first imported into the state. It also eliminated tax-free interdistributor sales. This new law took effect on June 1, 1985.

Now the 8 cents per gallon motor fuel tax and a prepayment of sales tax are required to be paid by the importer (or refiner) and both taxes are passed through to subsequent purchasers. At the time of sale to the ultimate consumer, sales tax is computed based on the actual selling price and on the local sales tax rate. Credit is taken for the passed through prepayment. Almost no tax-free transactions are permitted. The exceptions are sales to governmental entities, sales to exempt hospitals and sales of gasoline which is immediately exported out of the state.

In addition to the legislation, our Department created a new bureau to pursue an ambitious motor fuel tax enforcement program. This program identifies suspect storage terminals and monitors shipments of petroleum into the State. This effort increases our ability to thwart potential evasion schemes and collect taxes due.

Since the implementation of the first import law and the intensified enforcement program, collections of both motor fuel tax and sales tax for gasoline have each risen 23% over comparable periods in 1984. More than $123 million in additional state and local revenue has been collected during the first nine months. Gasoline excise tax receipts increased $63 million and state and local sales tax revenues increased $60 million. I have provided the Subcommittee with charts which detail these increases.

It is obvious our new law and enforcement efforts are having a substantial effect.

However, I should point out that we are not now and never were convinced that the first import law was a panacea that would solve solve all of the tax evasion problems in the petroleum industry. While these changes made tax evasion more difficult, they did not make it impossible. The "daisy chain" is gone but new schemes are evolving.

No sooner had the new law gone into effect, than organized crime was looking for loopholes and new schemes. They have a great stake in tax evasion and massive resources to accomplish it -- computers, high-priced attorneys, thugs, and nearly unlimited capital.

Within six months of the new law, and despite a number of administrative and enforcement actions involving stricter bonding requirements, review of distributor licenses and increased surveillance, we knew we had to do more. As a result, we proposed and our Legislature recently passed a First Import Enforcement Enhancement law which will shut down some of the new schemes and wrinkles which have surfaced, such as the "buy out/bust out" scheme, and help deter increased physical bootlegging.

A typical "buy out/bust out" scheme involves transfer to tax evaders of the stock of a corporation which is registered as a distributor. Under current law, change of stock ownership does not have to be reported to us and re-registration is not required. The new officers of the corporation are often paid only to be named as officers and have no assets. In two recent cases, the principal officers were immigrants regularly employed as a waiter and a janitor. The new stock holders of the corporation import substantial amounts of gasoline and do not pay the tax. They may operate for one to three months before we catch up with them. When we do, we find neither the corporation nor the officers have assets and frequently the officers have left the country.

Our recently passed enforcement enhancement legislation, which Governor Cuomo is expected to sign shortly, provides for required re-registration of a distributor if a significant portion of stock is transferred. It also makes it illegal to operate a motor fuel terminal or to transport motor fuel by barge, pipeline or truck into New York State without holding a valid license to do so. In addition, it gives us even stronger penalties for tax evasion and enhanced powers to seize fuel and transportation equipment when gasoline bootlegging occurs. Another provision of this law requires the Tax Department to conduct a study of a system for tracking the movement of motor fuel into the State.

This most recent enhancement of our enforcement capabilities will help, but the battle is far from over. This problem demands federal attention. Increased federal involvement would not only complement State efforts to combat evasion of State taxes; it would also raise additional federal revenues from improved compliance with federal taxes on motor fuel.

Just two weeks ago our agents seized 900,000 gallons of gasoline imported using a revoked license for a distributorship which had just been sold. This single isolated seizure, no doubt, represents a loss of $81,000 in federal gasoline excise tax. Just one week ago, we impounded another 470,000 gallons of illegally imported gasoline.

If the federal government, through the measures I suggest, were to recover excise taxes at only one-half the rate New York has been able to, it would still represent more than $1 billion annually in increased federal revenues. This estimate is based on federal gasoline excise tax collections data from the Budget of the United States (FY 1986) and the 23% revenue increase experienced by New York. And I submit the gain cold be much higher.

Our industry advisors and our own investigators are reporting more and more evidence of schemes where all state taxes are being paid while the crooks have turned their attention exclusively to evading federal taxes.

An example of this came to light in December of this past year as we were engaged in a trial in Federal Court on Long Island in order to prevent the proported "new" owners of a large marine storage terminal from reopening that facility. We had closed down that facility in August because of suspected bootlegging activities taking place there. Subsequently, the owner sold the terminal. It was our contention that the new owner was no more than an agent of the former owners, and we were successful in the Federal action in keeping the terminal closed.

During that trial it was shown that the purported new owner, a registered New York distributor of motor fuel, had for several months been purchasing motor fuel from sham corporations who had imported it into the State. These corporations importing the motor fuel were liable for tax. To our great surprise, however, even though not directly liable for the tax, the purported new owner reported the shipments of motor fuel into the State by the sham corporations on his New York motor fuel tax return and paid the tax.

At first we were perplexed as to why, after going through all the painstaking structuring and documentation to make it appear that the sham corporations were importing the fuel into New York, and thus liable for the tax, the tax was being paid by the New York distributor, the actual purchaser of the motor fuel. The only explanation that we can provide for the elaborate deceit is that the schemes were employed to evade the Federal excise taxes. It appears that the parties were fearful that their scheme would be uncovered by the New York authorities so they limited the evasion to the Federal tax.

In several other instances where a party, other than the party legally liable to pay the tax, was paying the New York tax, it appears to our people that the schemes are being employed to evade the Federal tax.

The final solution of this problem cries for increased involvement and resources of the federal government. This federal involvement should take several forms:

1) Enactment of a strict federal "first import law" which moves the incidence of the federal gasoline excise tax up to the point of refining or importation into the country and eliminates tax-free sales between importers, producers, or wholesalers.

2) The imposition of basic federal licensing and reporting requirements including:

   a) central national registration for importers and refiners

   b) minimum licensing and bonding requirements

   c) monthly as opposed to quarterly filing requirements, and

   d) a detailed motor fuel excise tax return.

One significant advantage of the adoption of this recommendation would be the greatly magnified effectiveness of our federal/state cooperative enforcement efforts.

3) A strengthened commitment to federal enforcement. This enforcement, wherever possible, should expand upon the cooperative federal/state approach that current NATA/IRS projects utilize. In addition, other existing cooperative programs should be continued and expanded. Currently New York State routinely notifies IRS of the results of its motor fuel tax audits. It is part of the Long Island Strike Force and is a participant in the NATA/IRS joint audit program.

A commitment to enforcement also involves making sure IRS has the staff to enhance enforcement. Proper enforcement requires resources.

4) The passage of H.R. 1605 making gasoline bootlegging a RICO crime. I applaud the passage of H.R. 6, a bill which includes a new requirement that the Army Corps of Engineers share information on barge traffic with state tax officials and look forward to its implementation.

5) Development of a joint federal/state motor fuel tracking system. States such as New York, New Jersey, and Florida that have major petroleum products docking, storage, and transshipping facilities are inundated with gasoline shipments. Sixty percent of all traffic in the Port of New York involves petroleum products. While the New York Tax Department is exploring our own verification code tracking system, the best tracking system would be national in scope.

6) Better coordination between the IRS, U.S. Customs, and the Environmental Protection Agency to address the twin problems of tax evasion and motor fuel adulteration. Adulteration of a petroleum product occurs when the product is mixed with foreign or lower quality substances. For example, the mixing of leaded and unleaded gasoline or the combining of petroleum products with waste material. Curiously, an EPA sweep of New York gas stations this February found that the incidence of fuel adulteration (which had been uncommonly high) has dropped drastically since the implementation of our First Import Law.

7) Attention to the problems associated with physical international borders such as those with Canada, and to the special problems connected with Indian reservations.

Some of the recommendations I have made would place additional burdens on the petroleum industry in the form of increased paperwork and the cash flow problem of up-fronting the tax if a strict tax on importation or refining were enacted. However, I would wager that most industry representatives would gladly shoulder those burdens if it meant the elimination of organized crime and tax evasion from the petroleum industry.

In closing, let me point out that in the era of Gramm-Rudman, there is no excuse for us allowing organized crime to line its pockets at the expense of the federal and state governments. New York is prepared to assist your efforts in every way possible.

Governor's Task Force on Administration of Taxes on Petroleum Products and Businesses

Report 1:

Recommendations on Enforcement and Reporting

April 1984

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ON PETROLEUM TAXES

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EXECUTIVE SUMMARY

I. INTRODUCTION

Over the past three years, attention has been sharply focused on the avoidance and underpayment of taxes on petroleum products and businesses in New York State. In November 1983, the Governor established a joint industry/government task force to propose solutions to the evasion of such taxes and to evaluate and make recommendations regarding their economic impact on consumers and the petroleum industry in New York State.

This is the first report on taxation to be issued by the task force. It primarily addresses strengthening the enforcement of tax programs and improving reporting mechanisms as a means of accounting for product distributed within the State.

II. PROGRAMS AND FISCAL IMPACT

The petroleum industry is responsible for paying or collecting the State's gross receipts tax, the motor fuel excise tax, the diesel motor fuel excise tax and State and local sales tax. Annually, these taxes account for approximately $1.1 billion in State/local revenues. Exact estimates of the revenues lost as a result of tax evasion for petroleum products and businesses are difficult to substantiate due to the complexity of trying to quantify the volume of bootlegged motor fuel, which by the very nature of bootlegging is an unreported, in fact purposely concealed, statistic. Based upon available data, the Department of Taxation and Finance estimates an annual loss of $75 million in State revenues and an additional $15 million in local revenues. Evasion of this extent is of concern not only to government, but also to legitimate businesses who are in competition with bootleggers.

III. STATEMENT OF PROBLEM

State and federal taxes on petroleum products can account for 40% of the cost of a gallon of gasoline. This provides an obvious enticement to evade some or all of these taxes.

Initially, the problem stems from the fact that virtually all of New York's petroleum supply is imported from out of state. To properly account for taxes, the State must be able to account for the billions of gallons of fuel imported by barge, pipeline and truck. Current reporting mechanisms for importation and movements within the State need refinement. The current organization of the enforcement function within the Department of Taxation and Finance and the limited authority granted to investigators hinders meaningful and effective investigations. Penalties applicable to noncompliance are nonexistent or insufficient to create a strong deterrent to evasion. Some penalties for evasion are misdemeanors, rather than felonies. In addition, the administrative practices of the Department need to be further enhanced in order to detect abuses in a timely fashion.

IV. ACTIONS TAKEN TO DATE

The Department, with support from the petroleum industry, has greatly increased its efforts to promptly detect evasion or underpayment, to make the best use of the resources available to it, and to protect the State's interest. The impact of these actions is significant. The results are being further evaluated for improved effectiveness. Among the actions taken are:

- A review of each distributor's financial stability and business activity and an increased bond or cancellation of registration where necessary
- Increased field and desk audit presence, including the gathering of information not required to be reported
- Increased surveillance and roadblocks
- Participation in a joint Federal/State/Local organized crime task force
- Increased reporting and cooperation among states.

In addition, legislation was enacted in 1982 to improve additional reporting requirements and drastically reduce the number of persons collecting tax.

V. TASK FORCE RECOMMENDATIONS

Despite the actions taken to date, the task force has identified organizational, legislative and administrative remedies, each of which address a specific enforcement problem. Individually, they do not provide a comprehensive solution. Collectively, they should provide a strong foundation for the State's enforcement program.

Although minority dissent or concern has been taken into consideration regarding specific proposals or the methodology for implementation of proposals, not all of the opinions of task force members could be accommodated in each proposal. As a result, the recommendations included are those supported in concept by the majority of the task force members.

The specific recommendations are:

A. Proposed Statutory and Organizational Changes to Give the Tax Department Broader Power While Enforcing Petroleum Tax Laws

1. Create an organizational unit with the capability within the Department to enforce provisions and investigate illegalities related to the taxes on motor fuel.

B. Legislative Changes to Strengthen the Enforcement Programs

1. Increase civil and criminal penalties for motor fuel tax evasion, particularly making the proven willful intent to evade taxes a felony instead of a misdemeanor.

2. Amend the law to provide for impounding and selling vehicles, vessels, and other conveyances transporting automotive fuel and their contents under certain circumstances related to tax evasion.

3. Hold officers of corporations subject to Article 12-A personally liable for taxes payable on petroleum products whenever the corporation has failed to pay its tax liabilities.

4. Impose a penalty on retailers of motor fuel or diesel motor fuel who assist in the evasion of taxes due and payable on such products.

C. Actions to Improve Reporting Requirements

1. Increase the Department's authority to examine the books and records of all persons and businesses transporting, storing, or possessing motor fuel.

2. Require that notification be sent to the Department when a distributorship changes its form of business entity, or if there is a change in officers or partners, and impose penalties which provide an adequate deterrent to noncompliance.

3. Require a written statement, basically through the invoice, by every seller to every purchaser, except for sales to retail consumers, indicating the amount of tax being charged or passed through. Also included would be number of gallons sold, type of fuel, etc. Penalties should be imposed on both the seller and the purchaser for failure to adhere to prescribed requirements.

4. Publish a directory of licensed distributors and exporters as well as a directory of tax violators and related movements of petroleum products within each category of tax.

5. Continue to analyze manual and computer based methodologies in order to improve coordination, compilation and utilization of information received on returns and information reports.

6. Continue to develop and encourage the coordination, cooperation and exchange of information among the states, such as the recently passed motion of the North Eastern State Tax Officials Association (NESTOA).

7. Establish a confidential departmental "Hot Line" which would receive information from industry personnel, as well as the consuming public, when situations of petroleum tax evasion are suspected.

I. INTRODUCTION

The New York State Department of Taxation and Finance (the Department) administers several taxes which derive their revenue from the sale or use of petroleum products or from petroleum business activity in New York State.

Attention of industry, State government and the media has sharply focused on the avoidance and underpayment of taxes on motor fuel, primarily on "bootlegging" -- the importation and sale of motor fuel in New York State without the payment of appropriate State taxes either by nonreporting or faulty reporting.

In response, the Department of Taxation and Finance established a task force in July of 1983 to propose appropriate solutions to the evasion of taxes on petroleum businesses or products.

Initial discussions with industry representatives and analyses by the task force clearly indicated that problems of tax evasion cannot be addressed adequately without the consideration of such other factors as tax structure, tax equity, adequacy of reporting requirements, and the effectiveness of enforcement and compliance.

As a result, the scope of the departmental task force was broadened, and in November 1983 that task force became part of an expanded joint industry/government task force established by the Governor.

Besides incorporating the original task force goals, the joint task force is evaluating the economic impact petroleum taxes have upon consumers and the petroleum industry in New York State and make recommendations to the Governor.

Although this report incorporates some issues included in the broadened scope of the joint task force, it primarily addresses the original mission of the departmental task force, which was to propose ways to counteract the evasion of taxes on petroleum businesses or products. This report primarily addresses measures which would strengthen the current enforcement of tax programs and improve reporting requirements as a means of identifying tax abuse on a timely basis.

Subsequent reports will focus on the remaining issues of the task force's initial charge, including tax structure and tax equity, and will contain consecutive chapters to those included herein.

II. FUEL DISTRIBUTION SYSTEM AND SUMMARY OF TAXES

To understand the problems related to the collection of taxes on petroleum products and businesses, it is necessary to be familiar with the motor fuel distribution system and the particular taxes that apply to it.

A. THE FUEL DISTRIBUTION SYSTEM

Due to a lack of domestic petroleum production/refining facilities, New York is reliant upon imports. To ensure that the proper taxes are collected on all petroleum products imported into the State, both business and government must be able to account for the product from the time it first enters the State to the point where it becomes subject to tax.

Most fuel initially enters the State by pipeline, tanker or barge. Several pipeline companies and numerous water transportation companies acting as "common carriers" deliver fuel to approximately 200 terminal sites in the State. In addition, some distributors operate their own vessels and/or import and deliver petroleum products to terminals in the State. Rail and truck transportation accounts for less than 10% of the fuel imported into the State.

Terminals may be owned and operated by oil companies or may be operated by businesses which receive a fee for storing the fuel. The ultimate distribution of petroleum products to end users or retailers is predominantly by truck. Trucks may be owned or operated by oil companies which import the fuel; by oil companies who purchase from the importer and resell the fuel; by large consumers or end-users, such as trucking or car leasing companies who maintain their own fleets; or by "common carriers" who are hired to transport the fuel. The Highway Use Tax Law requires that all vehicles transporting fuel receive special permits. Over 9,400 permits have been issued to 2,400 truck operators.

Relatively few of the 650 registered importers operating in New York are fully integrated petroleum companies which produce, refine, transport, wholesale, and retail petroleum products. Many more are independents who purchase an already refined product for resale in the State. In addition, there are wholesalers who do not import yet purchase refined product for resale in New York State. Importers and non-importers compete for many of the same customers, including approximately 10,000 retail service stations operating in the State.

Imported petroleum product is sold between branded companies or independents. Branded or unbranded fuel may be purchased from a multitude of established sources or on the spot market, and sometimes through brokers who arrange for the purchase and/or transportation of the products for a fee.

In addition to a straight sale/purchase agreement, exchange sales may occur. Exchanges involve agreements under which one party permits the other to pick up the product in one market in exchange for a reciprocal privilege in another market. These exchanges may take place without the benefit of an invoice. However, exchange statements are normally prepared by both parties and reconciled monthly. At some point, the companies account for the balance of product which changes hands as a result of many such transfers, and a final accounting is made either in money or product.

B. SUMMARY OF TAXES

1. Motor Fuel and Diesel Motor Fuel Excise Tax (Article 12-A)

Article 12-A of the Tax Law imposes an excise tax on motor fuel (gasoline, aviation fuel, and propane) and diesel motor fuel sold or used in New York State.

In addition to statewide taxes on these products, the City of New York imposes a separate tax on leaded motor fuel sold in the City.

The specific rates of tax imposed are:

-- 8¢ per gallon State tax on motor fuel

-- 10¢ per gallon State tax on diesel motor fuel

-- 1¢ per gallon New York City tax on leaded motor fuel

The Department of Taxation and Finance collects these taxes from businesses which are registered as "distributors". The Tax Law differentiates between motor fuel distributors and diesel motor fuel distributors.

A "motor fuel distributor" is a person or business that imports or causes motor fuel to be imported into the State for use, distribution or sale within the State. Determining who must register as a distributor is governed by the point (in State or out-of-State) where title passes from the seller to the purchaser. /1

A "diesel motor fuel distributor" may be either a retail vendor, a bulk user or a truck operator. /1

While the tax is collected and remitted by distributors, the incidence of the tax falls on the final use of the fuel on the highways or waterways of New York. Fuel not used on

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/1 For further clarification of either of these definitions refer to the glossary of terms included as an appendix to this report.

the highway or in pleasure craft is not subject to these taxes.

The administrative provisions of the law, regulations and procedures for these taxes attempt to secure the revenues due the State by considering the financial solvency or dependability of distributors collecting the tax and by providing recordkeeping and reporting mechanisms whereby all purchases and sales by distributors are reported in a way that can be confirmed against sales reported by others.

- Registration

All persons meeting the qualifications of a motor fuel distributor or diesel motor fuel distributor must register by filing specific application forms which require routine information as well as more specific data such as the names of corporate officers.

The registration application must be accompanied by a financial statement and an estimate of the number of gallons expected to be sold or used per month. The Department then evaluates the distributor's ability to meet any motor fuel or diesel motor fuel tax liability which may be accrued. The registrant's current ratio (current assets to current liabilities), net worth, estimated tax liability, compliance with other taxes, and other known information about the taxpayer provide the basis upon which the Department determines whether or not to require a bond for all or a portion of the distributor's estimated six month tax liability.

- Purchases by Distributors

New York distributors of motor fuel and diesel motor fuel may make tax-exempt purchases from other New York distributors. Each tax-free sale and purchase between distributors is required to be recorded on schedules attached to the seller's and purchaser's monthly tax return.

In the case of diesel motor fuel, the distributor often purchases diesel fuel from a supplier who is not a registered distributor. For example, the supplier might be a residential heating oil supplier with no obligation to register as a distributor. Upon making a sale to a diesel distributor, the nondistributor must also submit a report to the State identifying the sale.

In the above cases, the State is then able to cross-check reports made by the seller and the purchaser. Additionally, a New York motor fuel distributor may purchase motor fuel out-of-State from another distributor. Where the seller is an out-of-New York State distributor, the sale to a New York State purchaser/distributor may be exempt from the New York tax and the other state's tax. In such cases,the out-of-State distributor is normally required to report the specifics of the tax-free sale to the home state. That state, in turn, may forward information regarding the sale to the New York State Department of Taxation and Finance, where the information is compared with purchases reported on the New York distributor's return. At present, 23 states (including all states bordering New York) and Canada report this information to New York on a reciprocal basis.

If a New York motor fuel distributor purchases fuel out-of-State from someone who is not a distributor in that state, the New York distributor is required to pay the other state's tax and the sale is not reported to New York by the other state. However, if the distributor asks the other state for a refund of the tax paid, information concerning the refund and purchase is provided to New York State.

- Sales or Use by a Distributor

The motor fuel excise tax is imposed upon fuel sold or used by a distributor. There are many situations in which the status or location of the purchaser permits tax-free sales (identified in the attached glossary of terms under "exempt transactions"). The distributor must keep detailed records establishing the validity of sales reported as tax-free.

- Taxable Incidence

Unless the purchaser is exempt from the motor fuel excise tax, any sale by a distributor directly into the tank of a motor vehicle is subject to tax. This applies to sales by diesel retail vendors who sell motor fuel at service stations they operate themselves. A motor fuel distributor operating a station incurs a liability when motor fuel is actually delivered into the storage tanks of the service station.

Bulk deliveries of motor fuel to bulk users, wholesalers (not registered as distributors), or to retail service stations are also taxable. The wholesaler or retailer is required to pay the motor fuel tax and pass it through to customers except in cases of exempt transactions as defined in the glossary.

Distributors may withdraw fuel from inventory for use in their own motor fuel or diesel motor fuel powered vehicles. Such usage is taxable and must be reported on the appropriate return.

- Reporting and Recordkeeping Requirements

Generally, motor fuel and diesel motor fuel tax returns are due monthly, by the 27th of the month following the month in which the taxable sale or use occurs. /2 Diesel fuel distributors with liabilities of less than $200 a month may elect to file quarterly.

All motor vehicles transporting motor fuel in New York must have a delivery ticket, called a "manifest", showing such information as the supplier, purchaser, and number of gallons.

- Penalties

Any motor fuel distributor who fails to file returns or pay tax due is subject to a penalty of 5% of the tax for the first month, or portion thereof, of delay and 1% for each additional month or portion thereof.

A penalty of $100 may also be imposed for each failure to file a diesel motor fuel return.

A misdemeanor fine of not more than $5,000 and/or imprisonment for one year may be levied against anyone who intentionally violates any provision of Article 12-A or who willfully attempts to evade or defeat the tax.

In addition, any distributor who files a willfully false return is guilty of a felony.

2. Sales Tax -- State and Local (Articles 28 and 29)

Sales tax is collected by motor fuel distributors on sales or use of motor fuel and by diesel motor fuel distributors on sales or use of diesel motor fuel. Although the tax is collected by the distributor, it is actually passed through and paid for by the ultimate consumer.

The terms "motor fuel distributor" and "diesel motor fuel distributor" have the same meaning for sales tax purposes as they do for motor fuel tax purposes; that is, a motor fuel distributor is an importer or refiner of motor fuel and a diesel motor fuel distributor is a retailer or bulk purchaser/user of diesel motor fuel. Truck operators who are not bulk purchasers are excluded from the sales tax definition of "diesel motor fuel distributor".

- Registration

Anyone engaged in any of the above activities must register as a sales tax vendor and also as a motor fuel or diesel motor fuel distributor. In addition, anyone who sells

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/2 The return for February is due March 20th, however.

either motor fuel or diesel motor fuel in this State, even though not a distributor, must register for sales tax purposes, keep certain records, and file information reports. There are no special bonding provisions upon registration for sales tax purposes.

- Purchases by Distributor

Registered New York State distributors may purchase fuel from other distributors without the payment of sales tax by presenting the seller with a properly completed exemption certificate. There are no special sales tax requirements for reporting tax-free sales made to other distributors.

Those purchasing all motor fuel or diesel motor fuel for immediate export and sale in another state may also purchase without the payment of sales tax by presenting the seller with a properly completed exemption certificate.

- Sales and Uses by Distributors

In general, sales of motor fuel are taxed when the purchaser is:

-- the ultimate consumer

-- an operator of a retail service station

-- a wholesaler who is not a registered motor fuel distributor

Sales of diesel motor fuel are taxed when the purchaser is the ultimate consumer.

Uses, such as the consumption of motor fuel and diesel motor fuel in its own trucks, by registered distributors are subject to tax and the tax is paid by the distributor with the regular sales tax returns.

- Exempt Purchases

Sales by distributors to anyone entitled to sales tax exemption can be made sales tax-free provided proper documentation is obtained from the purchaser. Purchases may be tax-free because of the nature of the purchaser (for example, a governmental agency, a charitable institution, or the United Nations) or because of the intended use of the fuel (for instance, in manufacturing or farming). As indicated above, distributors can purchase fuel without paying sales tax.

- Reporting and Recordkeeping Requirements

Distributors are required to file returns and pay sales tax quarterly unless they have taxable sales of over 100,000 gallons or have taxable sales of over $300,000 in any quarter. Those large volume distributors are required to file and pay monthly.

All sellers of motor fuel or diesel motor fuel are required to file quarterly information reports, to keep detailed records of all transactions involving those fuels for at least three years and to make these records available to the Tax Commission on request.

- Penalties and Interest

The penalty for failing to file a sales tax return or for not paying the tax due is 5% of the tax due for the first month and 1% a month for each additional month, with a maximum of 25%. Interest is 1% a month or 1/12 of the annual rate in effect (set by the Tax Commission), whichever is greater.

A misdemeanor fine of not more than $1,000 and/or imprisonment for up to one year may be imposed against anyone who intentionally violates certain provisions of Articles 28 and 29 of the Tax Law.

3. Gross Receipts Tax (Article 13-A)

Laws enacted in 1980 and 1981 and early 1983 imposed taxes on the gross receipts of certain petroleum companies in New York State and in some instances provided for the reporting of business corporation tax on a unitary basis. These laws were repealed and a new tax (Article 13-A) on gross receipts of petroleum businesses was imposed.

Effective July 1, 1983, a privilege tax was imposed on all New York businesses, incorporated or unincorporated, engaged in importing or causing the import of petroleum for sale in New York or engaged in extracting, producing, refining, manufacturing or compounding petroleum. Effective April 1, 1984, Chapter 67 and 68 of the Laws of 1984, imposed the gross receipts tax on businesses which import or cause petroleum to be imported into this State for their own consumption in this State. The tax is computed on gross receipts from sales of petroleum and consideration paid for petroleum imported for self-use in New York State at the following rates:

RATE	LIABILITY PERIOD
3 1/4%	7/1/83 - 3/31/84
2 3/4%	4/1/84 - 6/30/85
3/4%	after 6/30/85

- Exclusions from Base

When computing the receipts subject to tax, certain items may be excluded from the base. These include:

-- sales of petroleum in New York to others subject to Article 13-A tax who will resell the product,

-- sales of fuel oil and liquified or liquifiable gases used for residential purposes,

-- exchange sales of petroleum between New York petroleum businesses, subject to Article 13-A, and

-- sales of petroleum for immediate exportation from New York.

- Reporting Requirements

Returns and taxes are due on or before the 15th day of the third month following the close of the business' taxable year, as determined for Federal tax purposes. If a petroleum business, taxable under Article 13-A of the Tax Law, determines or can reasonably expect that the tax under Article 13-A will exceed $1,000 for the taxable period, then it must file a declaration of estimated tax and pay the estimated tax shown to be due thereon. The declaration and payments of estimated tax are subject to further provisions set forth in law.

The Article's other administrative and procedural provisions correspond to provisions for other corporation business taxes.

4. Spill Fee

The Department of Transportation collects a fee at a flat rate of 1¢ per barrel on all petroleum products imported and placed in a major storage facility in New York State. The spill fee is paid by terminal operators who may or may not be subject to any of the other aforementioned taxes.

The approximately $3.5 million per year collected from this fee is deposited into the New York State Environmental Protection and Spill Compensation Fund and is used to finance the administration and clean-up of oil spills in the State. The fee may be adjusted up to 4¢ per barrel when the fund has been depleted or encumbered by an amount in excess of its balance.

III. FISCAL IMPACT, ENFORCEMENT PROBLEMS, AND ACTIONS TAKEN TO DATE

A. FISCAL IMPACT

The Department of Taxation and Finance collects approximately $1.1 billion annually from the State and local taxes imposed on petroleum companies and products, excluding the spill fee. Of this amount, approximately 77% is equally split between the motor fuel excise tax and State and local sales taxes. The diesel motor fuel tax generates only 3% of the revenues, with the gross receipts tax producing the balance of 20%.

Exact estimates of taxes lost are difficult to substantiate due to the complexity of trying to quantify the volume of bootlegged gasoline which, by the very nature of bootlegging, is an unreported, in fact purposely concealed, statistic.

The upper range of estimates appears to be overstated and not supportable by available statistics at the Federal, State, and local levels. In fact, some of the estimates overstate losses to the State since they include lost Federal taxes on petroleum products.

Based upon the statistics which are available and current audit experience, the Department of Taxation and Finance estimates an annual revenue loss to the State of approximately $75 million. Local taxing authorities may be losing an additional $15 million. However, due to the admittedly unquantifiable nature of bootlegging, the Department acknowledges that these figures could be higher.

B. ENFORCEMENT PROBLEMS

There are special factors which make the evasion of taxes on petroleum products and companies lucrative.

Total Federal, State, and local taxes on petroleum activities account for approximately 40% of the cost of a gallon of gasoline. If a business is able to evade all or most of the taxes, a substantial - but illegal - profit can be realized. For example, a tractor-trailer load of motor fuel contains approximately 8,000 gallons. A distributor who can evade State taxes and still sell the fuel at the market rate will make an illegal profit of at least $1,200.

In other instances, a bootlegger can purchase fuel in another state, pay the other state's applicable taxes and still realize an illegal profit upon its sale in New York. As a case in point, a bootlegger may buy fuel in another state where only a motor fuel excise tax is imposed. The bootlegger could pay the other state's tax, and from the other state's perspective, this transaction is beyond suspicion since all taxes have been paid. Upon importation into New York, however, the importer (bootlegger) should register with the Department and account for and collect all appropriate New York State taxes. But, if the importer fails to report and account for and pay the tax on the fuel imported from out-of-State, the bootlegger could realize an illegal profit of the difference between the total New York taxes which should have been collected and the motor fuel tax paid the other state. The loss to New York State and localities is even greater than the distributor's illegal profit, since New York loses the revenue from all taxes evaded.

Other complexities in the administration and enforcement of taxes within New York State inhibit the detection of tax evasion:

1. Provisions in Law

The administration and enforcement of motor fuel taxes is affected by complexities and inconsistencies in the Tax Law. For example, although corporate officers are liable for a corporation's sales or withholding taxes in case of corporate default, the Tax Law does not include a similar provision for motor fuel and diesel excise taxes as a deterrent to tax evasion. Also, penalties exist for distributors who evade tax payments on petroleum products. Similar penalties do not exist in cases where a retailer has willfully and knowingly purchased products on which taxes have not been paid.

2. Distribution System

Within the fuel distribution system, a product may change hands numerous times before the transaction at which taxes are payable, causing difficulties in tracing tax accountability. Each time a product is sold, certain factors such as the status (taxable or exempt) of the customer, the point of delivery, or the use of the product must be considered before it can be determined if or how much tax should be collected. Such considerations cause difficulties not only for businesses in the distribution chain which must determine their tax liability for each transaction but also for the Tax Department which exerts substantial effort to trace the tax accountability.

3. Administrative Controls

Current information and reports that businesses are required to file with the Department do not provide adequate detail to account for and trace the movement of petroleum products within the distribution system, thus making it difficult to verify irregularities within the system on a timely basis. Legislative changes to reporting mechanisms are necessary to improve the data actually being reported to the Department. The Department must also implement improved procedures to more effectively utilize both new data being sought as well as currently available information.

4. Investigative Capabilities

Currently, the Department has authorized staff for the investigation of cigarette tax evasion only, but nevertheless, this staff has also been utilized to monitor the transportation of motor fuel.

However, the provisions of existing law governing the illegal movement of petroleum products by which the tax has been evaded are extremely weak. This means that the Department investigators have limited enforcement authority under current law to combat bootlegging. For example:

a. If Department staff actually track a tanker truck which is believed to be carrying bootlegged gasoline, the maximum charges that can be brought at that time are misdemeanors -- transporting automotive fuel without being a licensed 12-A distributor or not carrying a proper delivery ticket, invoice or manifest.

b. Department staff being utilized for tracking tank trucks suspected of carrying bootlegged gasoline have peace officer status and thus can, if necessary, make arrests in certain instances. However, since their peace officer status derives from special legislation giving such status only for purposes of cigarette tax enforcement, there is a natural and proper reluctance to utilize the status for other purposes, even though technically legal. For this and other reasons, a summons, rather than an arrest, is the primary weapon against a violation.

c. Upon stopping a transporter of suspected contraband material who produces what appears to be a proper license and proper delivery tickets, invoices or manifests, the Department's options are limited. A crime may be established in one of three ways:

    -- To wait until the carrier unloads cargo either at a point or in a quantity which differs from indications on the delivery ticket, invoice or manifest;

    -- To wait until a tax return has not been filed, indicating that tax has not been paid on the particular tanker load in question; or,

    -- If the delivery ticket, invoice or manifest are apparently in order and a tax return has been filed, to audit the distributor's entire operation to verify that taxes had not been paid on the particular tanker load in question.

More importantly, even when a violation is established, the Department has no authority to seize and sell contraband petroleum products or the transport vehicle in order to satisfy motor fuel and sales tax obligations due the State and localities. Such authority exists for similar violations of cigarette tax laws and is a major deterrent.

C. ACTION TAKEN TO DATE

A number of actions have been taken to combat the problems mentioned above:

1. Review of Distributor Licenses

The Department has completed a program which required all previously registered motor fuel distributors to submit information regarding their operations and current financial condition. As a result of this review, several licenses were withdrawn for questionable operations and other distributors were required to obtain or increase bonding in order to assure the State adequate payment of tax revenues in case of default by the distributor.

2. Increased Reporting Requirements

As a result of increased reporting requirements implemented in 1982, meaningful comparisons of motor fuel excise and sales tax returns can be made and major discrepancies noted for audit follow-up. In addition, all transporters of automotive fuel are required to display decals identifying the vehicle as a carrier of petroleum products and to carry detailed manifests or bills of lading for each shipment. This has simplified Departmental enforcement efforts and created a more accurate audit trail.

3. Increased Audit Review

The Department has expanded its audit coverage of motor fuel and diesel motor fuel distributors. The frequency with which these taxpayers will be reaudited will be increased.

Recently, the Department's Audit Division has developed computer-assisted audit techniques which substantially reduce audit time required to verify the large volume of complex transactions handled by distributors.

In addition, Department personnel have been assigned to gather information not currently reported to the Department, from various tank farms and gasoline storage terminals. The availability of such information should aid in identifying companies importing motor fuel which are not registered as distributors and discrepancies between the gallonage of motor fuel sold as reported to the Department by registered motor fuel distributors and the gallonage actually imported.

4. Increased Enforcement by Cigarette Tax Enforcement Bureau

Other sections of this report note restraints on the Department's ability to actively enforce all tax programs and make arrests for illegalities. In spite of restrictions, the Department has proceeded to take those actions within its authority, such as increasing surveillance and conducting roadblocks. In addition, the Department has solicited the cooperation of other states, the Port Authority, the City of New York, local and State law enforcement agencies, and U.S. Customs. Investigators have also started to verify records of barge operations regarding the seller, purchaser and point of delivery of fuel.

Moreover, in-State and out-of-State surveillance activity has been increased. Specific information is recorded regarding the movement of delivery vehicles. Contact has been made with other states' taxing authorities to aid in ascertaining the actual delivery point of the motor fuel being loaded.

Finally, the Department is a participant in a joint Federal, State and local organized crime task force which is looking at major criminal activities within the petroleum industry. As a result of the investigations of the task force, New York State investigators have made several arrests of both distributors and retailers.

5. Change in Incidence of Liability for Sales Taxes

Effective September 1982, new legislation shifted the liability for remitting the sales tax on motor fuel from approximately 10,000 retailers to about 650 registered motor fuel distributors. This reduction in the number of businesses responsible for collecting and remitting the sales tax was expected to simplify the State's efforts to collect and audit tax receipts on motor fuel as well as verify transfers and sales of the product.

6. Increased Cooperation Among the Northeastern States

The Commissioner of Taxation and Finance has made a special effort within recent months to discuss with other tax officials of northeastern states methods for pooling resources to combat motor fuel tax evasion. A task force has been established by the North Eastern State Tax Officials Association (NESTOA) to develop an automated reporting and reconciliation system which would allow computerized reporting by motor fuel distributors and importers for use in motor fuel tax administration by participating member states. A second task force has been created by NESTOA to evaluate the feasibility of cooperative tax enforcement programs among member states.

7. Requested Federal Participation

The Department has requested that Federal legislation be introduced to permit the release of information possessed by the U.S. Army Corps of Engineers on the transportation of motor fuel by barge in the New York harbor and adjacent waterways. By Federal law, the Corps of Engineers is presently prohibited from disclosing this information.

In view of the growth of motor fuel tax fraud as a national problem, the Department has solicited Federal funds to support the states in their efforts to increase enforcement and overcome motor fuel tax evasion. Similar funding has been available in the past for abuses related to cigarette tax evasion and was responsible for pulling together the resources necessary to combat the problem.

IV. RECOMMENDATIONS

ENFORCEMENT AND REPORTING

The recommendations that follow are the result of many months of effort of the joint government/industry task force established by the Governor. They embody the suggestions received from diverse public and private interests which share a mutual concern for ensuring full compliance with the Tax Law.

Although minority dissent or concern has been taken into consideration regarding specific proposals or the methodology for implementation of proposals, not all of the opinions of task force members could be accommodated in each proposal. As a result, the recommendations included are those supported in concept by the majority of the task force members.

Additional proposals addressing tax structure and tax equity are still under review and discussion by the task force. The task force will make further recommendations to the Governor when a consensus of opinion is reached.

Given these considerations, this report addresses recommendations strictly aimed at strengthening the State's tax enforcement program and improving reporting requirements which support and aid the enforcement effort.

A. PROPOSED STATUTORY AND ORGANIZATIONAL CHANGES TO GIVE THE TAX DEPARTMENT BROADER POWER WHILE ENFORCING PETROLEUM TAX LAWS

1. Create an Organizational Unit with the Capability within the Department to Enforce Provisions and Investigate Illegalities Related to the Taxes on Motor Fuel

The petroleum industry has urged the creation of an organizational unit dedicated to performing investigations and enforcing criminal provisions related to taxes on petroleum products or businesses.

The Department acknowledges that the only organization responsible for conducting investigations and making arrests - the Cigarette Tax Enforcement Unit - has limited jurisdiction and does not have the legal authority to make a significant impact upon the problems of petroleum tax evasion.

Although the unit is primarily engaged in cigarette tax enforcement activities, it has, however, been utilized for petroleum tax enforcement in those limited instances where such activity is allowable within current legal restraints.

There are various alternatives regarding the organization best suited to pursuing the oil tax evasion problem. The task force concluded that an investigations and enforcement unit with authority for taxes on petroleum companies and products should be established within the Department of Taxation and Finance. For such a unit to be effective, statutes must be modified to strengthen and support enforcement powers of the Department.

Currently, Departmental peace officer status derives from legislation giving such status for purposes of cigarette tax enforcement only. Thus, investigators are more limited where they are not involved in carrying out this charge.

An increased emphasis on enforcement strengthens the Department's ability to fulfill its responsibility for tax collection. Without adequate authority to apprehend willful tax violators, collection of some major tax debts becomes virtually impossible through standard tax collection procedures. Under current law, arrests may be delayed to a point where an illegal business may continue to amass additional petroleum tax revenues and/or discontinue activity before the State can adequately act to collect taxes payable.

Peace officer status for petroleum taxes would confer more direct authority to take actions which expedite investigations and arrests. It would permit Department investigators to make earlier arrests since (1) the arrests can be made when the investigator has reasonable cause to believe a crime has been committed rather than the investigator having to actually witness the crime and (2) assistance does not need to be solicited from legally authorized enforcement officials at federal, state, or local levels. Earlier arrests made possible by peace officer status would allow quicker recovery of tax liabilities.

The task force supports the passage of legislation which would confer peace officer status on designated Department investigators for all taxes on petroleum businesses and products. The task force is fully cognizant that such powers must by exercised wisely and applied equitably towards all taxpayers. If such legislation were to become law, there is an obvious need for the Department to develop regulations and administrative practices and procedures which will ensure that these powers are not abused.

The Department of Taxation and Finance supports this broadening of its investigative and enforcement capabilities. The Department, however, advocates an even broader expansion into areas other than motor fuel tax and cigarette tax. /3

B. OTHER PROPOSED CHANGES TO STATUTES TO STRENGTHEN THE ENFORCEMENT PROGRAM

1. Increase Civil and Criminal Penalties for Motor Fuel Tax Evasion, Particularly Making the Proven Willful Intent to Evade Taxes a Felony Instead of a Misdemeanor

If increased enforcement efforts are to be effective, the penalties and risks assigned to crimes committed must be substantial enough to initially deter crime as well as discourage its repetition.

Presently, penalties for motor fuel tax law violations are not proportionate to potential monetary gain for criminals. For instance, if Department staff actually track a tanker truck believed to be carrying bootlegged gasoline, the only charges that can be brought at that time are misdemeanors -- transporting gas without being a licensed 12-A distributor or not carrying proper manifests. Generally the penalty imposed for failure to carry a manifest is a fine from $100 to $500.

And although the maximum fine for being unlicensed can be $5,000 and up to a year in jail, many bootleggers are licensed. They evade taxes, instead, through false tax reporting, use of counterfeit manifests, and other similar methods of tax evasion.

Only through increasing the penalties for all forms of willful violation of the payment of taxes on petroleum

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/3 The results of audits, flea market inspections and other departmental operations indicate that evasion is not limited to taxes on cigarettes or motor fuel. The Department believes the task force recommendation represents a piecemeal approach, that fails to address the Department's overall enforcement problems. If this example were followed for other tax areas, it would result in the creation of a succession of individual units, with peace officer status, each devoted to a specific tax. Such individualized units would not be the most effective means of ensuring compliance or utilizing the Department's already scarce resources. While the Department recognizes that motor fuel tax investigations are an immediate priority, it believes it should also have the authority and ability to assign investigators or utilize resources where the greatest need is recognized. In many cases, the detection of evasion in one tax can lead to a finding of evasion in another. To provide a deterrent, to maximize compliance, and to ensure that enforcement efforts are effectively managed, the Department advocates the creation of a multi-purpose division of enforcement and the passage of legislation extending peace officer status into other tax areas.

products will the Tax Department's enforcement program be able to become effective and give violators reason to think more carefully about committing a crime.

Increased penalty provisions would not be unusual since a model for legislation can already be found in current laws related to cigarette bootlegging.

Legislation has been drafted by the Department to impose appropriate penalties for tax evasion.

2. Amend the Law to Provide for Impounding and Selling Vehicles, Vessels, and Other Conveyances Transporting Automotive Fuel and Their Contents Under Certain Circumstances Related to Tax Evasion

Currently, investigators may impound vehicles and their contents only as evidence when appropriate registrations or manifests are not provided, releasing them when matters are satisfactorily resolved or a determination is made by the courts - even if a crime is determined. Even if a taxpayer is found guilty of tax evasion, the transporter and fuel are returned to him/her when taxes have been paid. The only instance where they may not be returned is when the taxpayer refuses to pay the taxes which have been assessed, and the Department is then able to establish a lien on personal property in order to secure payment of the debt.

The task force recommends extending impoundment authority to include the ability to sell the vehicle and/or its contents when more serious violations occur and crimes are actually determined, whether or not taxes are eventually paid.

Since a vehicle transporting petroleum products requires a significant capital investment, the possible loss of such a vehicle, as well as its contents, should act as a serious deterrent to bootlegging and improve current reporting compliance.

Vehicles, vessels, and other conveyances could be seized and sold when: (1) they contain products on which taxes have not but should have been paid; (2) the transporter is not a person authorized or registered to import product into New York State; or (3) the transporter has falsified the required permits or documents or such documents are deficient in material respects from that which the law requires.

However, legislation would also provide for appropriate due process protection, including appropriate inquiries by the district attorney or corporation counsel and court proceedings, upon notice, before a forfeiture could be declared.

A model for legislation can be found in the current provisions related to cigarette bootlegging.

The Department has already drafted proposed legislation.

3. Hold Officers of Corporations Subject to Article 12-A Personally Liable for Taxes Payable on Petroleum Products Whenever the Corporation has Failed to Pay its Tax Liabilities

Responsible corporate officers are held personally liable for unpaid sales and withholding taxes. There are no similar provisions in the motor fuel or diesel motor fuel tax laws. Individuals participate in willful tax-evasion schemes for motor fuel knowing that the liability for tax rests with the distributor as a business or corporation. They might act more responsibly if they could become personally liable for any tax violations by their corporation.

In addition, this type of personal liability should reduce tax avoidance schemes where dummy corporations are dissolved before tax liability can be collected by the State or all corporate assets are transferred to corporate officers to avoid payment of taxes.

Proposed legislation has been prepared by the Department.

4. Impose a Penalty on Retailers of Motor Fuel or Diesel Motor Fuel who Assist in the Evasion of Taxes Due and Payable on Such Products

Retailers may be tempted to take advantage of price differentials on petroleum products to increase business or remain competitive. In doing so, the retailer currently remains free from liability or criminal prosecution as long as definitive collusion with the distributor cannot be proven. But, in some instances, a retailer could clearly question the probability of taxes having been paid on fuel when the price on a fuel shipment differs substantially from those shipments offered for purchase from other sources. In these cases, as well as those of proven collusion, a retailer should be expected to accept responsibility for at least checking the invoice on the shipment to verify whether taxes have been paid.

Imposing a penalty on retailers would discourage the purchase of bootlegged fuel. The penalty might be assessed as a fall-back provision whenever the distributor has failed to pay taxes and is unreachable for payment of the liability under current law and regulations -- for instance, when a distributor has gone out of business before taxes could be collected.

In fairness to retailers, however, provisions must include due process standards and reasonable criteria to protect innocent purchasers.

The Department has drafted legislation addressing this issue.

C. PROPOSED ACTION TO IMPROVE REPORTING REQUIREMENTS WHICH WOULD AID IN IDENTIFYING TAX ABUSE

Petroleum products move freely, both in fact and on paper, between and among some 650 distributors. Tracing fuel movements is difficult in and of itself, and becomes more difficult since sales and transfers between distributors are tax-free. Audit trails may be intentionally obscured by a long chain of transfers and sales or through improper recording of related information.

Serious attention must be focused on how information is being reported for tax purposes. In addition, the State should utilize any additional reporting mechanisms available which would aid in identifying tax abuse.

1. Increase the Department's Authority to Examine the Books and Records of all Persons and Businesses Transporting, Storing or Possessing Motor Fuels

While a small percentage of fuel is imported into New York by truck and delivered directly to retail service stations, most is imported by barge or pipeline and placed into major storage facilities or terminals prior to its being distributed throughout the State. In many cases these storage facilities or terminals are operated by persons other than those which own the fuel. Currently, the Department has no legal authority to require registration or reporting by these facilities. The Department would have greater accountability and control over the flow of product throughout the State if it knew the details of all product imported and stored at such facilities.

The Department is currently receiving information provided voluntarily by several terminal or transportation companies. Preliminary results indicate that this information is valuable in detecting otherwise unreported fuel in the State. Unfortunately, some facilities have failed to cooperate with the Department's requests for information.

As a result, the Department has drafted legislation giving the Department the authority to examine the books and records of storage facilities, transportation companies and others in possession or control of fuel.

The Department is continuing to assess the need for additional controls. Eventually it may become necessary to require, by legislation, mandatory registration and filing of information reports by this group. Should this become necessary the industry has offered to assist in developing reporting mechanisms which would be helpful in detecting abuse, yet be least burdensome on the industry.

2. Require That Notification be Sent to the Department When a Distributorship Changes Its Form Of Business Entity, Or If There is a Change In Officers Or Partners, and Impose Penalties Which Provide an Adequate Deterrent to Noncompliance

Currently, the Tax Law requires that a distributor should immediately notify the Department in writing of any changes in its business entity or, if a corporation, of any change in its officers or their address. Compliance with this provision has been lacking and often is hard to detect until such time as an audit is conducted. The need for this type of information is becoming increasingly important.

More and more, the Department is seeing cases where an individual with a known or suspected history of bootlegging or evasion has been able to purchase the stock of an ongoing distributorship and establish him/herself as a responsible officer. If so inclined, the individual could use this new acquisition for carrying out additional evasion schemes. While the transfer of stock does not constitute a change in entity, there is a responsibility for reporting a change in officers. If the Department had the information about the involvement of this type of individual, it could undertake a thorough review of the business and consider several actions including the cancellation of the distributor's registration or increasing their bond.

Under current law, penalties for noncompliance with this provision offer little incentive to comply. The officer is not personally liable for the tax and if he can hide or divert illegal profits to himself, has little to lose.

To combat this problem, the Department has prepared legislation which would require notification of changes in partners and which would eliminate any statute of limitations for assessing liabilities when these types of reporting provisions have not been adhered to.

If this measure and the prior recommendation (Section IV.B.3.) for holding officers personally liable are enacted, there would be an increased incentive for persons to comply. Even in the cases where there is noncompliance, the Department's position would be strengthened since a lien against the personal assets of the officers could be established for taxes due.

3. Require a Written Statement, Basically Through the Invoice, by Every Seller to Every Purchaser, Except for Sales to Retail Consumers, Indicating the Amount of Tax Being Charged or Passed Through. Also Included Would Be Number of Gallons Sold, Type of Fuel, etc. Penalties Should Be Imposed on Both the Seller and the Purchaser for Failure to Adhere to Prescribed Requirements

Requiring a statement of taxes paid between sellers and purchasers forces each participant in the distribution chain to verify that taxes have been paid. The lack of such information on an invoice or other related document could be used to prove negligence on the parts of both the seller and the purchaser in verifying that tax liabilities owed the State have been paid. This measure serves as additional support for the earlier recommendation which would impose liability for taxes due upon retailers. Additional information requested would also assist in establishing the point of tax liability.

The industry has suggested some criteria to be applied uniformly for all motor fuel movements for both the delivery document and invoice. Appropriate legislation would need to be drafted to mandate reporting requirements and assign penalties for noncompliance.

4. Publish a Directory of Licensed Distributors and Exporters as well as a Directory of Tax Violators and Related Movements of Petroleum Products within Each Category of Tax

Industry representatives believe that a directory of distributors, including their taxable gallonage, and a listing of proven tax violators would aid distributors and purchasers of petroleum products in determining if in fact they are dealing with a reputable distributor or one who has a record of tax violations, and if sales are tax-free due to the fact that they are either inter-distributor or for export.

Although such a directory may be beneficial, additional research must be completed to determine what difficulties may be encountered in current law to prohibit or restrict publication and if statutory authorization is necessary to legally release the type of information which would be in such a report.

If it is determined that this issue cannot be resolved administratively, appropriate legislation will be drafted.

5. Continue to Analyze Manual and Computer-Based Methodologies in Order to Improve Coordination, Compilation and Utilization of Information Received on Returns and Related Information Reports

Once a return filing date has been reached, it is incumbent upon the Department to process returns; determine delinquencies, liabilities or inconsistencies; and take appropriate action as soon as possible. Failure to do so promptly gives bootleggers or distributors an opportunity to accumulate additional illegal profits, to go out of business, or to hide assets beyond the reach of the State.

The Department has taken numerous steps designed to accelerate the above process. Motor fuel delinquencies or cases of underpayment are identified and assessments are issued promptly. Frequently, information filed on a sales tax return will be verified or checked against motor fuel tax returns or against information obtained from independent or third party sources, and more and more returns are receiving a priority desk audit shortly after their receipt.

The Department recognizes the need to further refine its ability to perform the above promptly, and is committed to developing and analyzing manual and computer-based methodologies in order to accelerate the above functions. One impediment to this is the failure of some distributors and vendors to provide complete information with their return or information report. In many instances, the failure to supply required information may not even affect that particular person's tax liability. The required information regarding that person's source of supply or customer may, however, prove to be the vital link in the chain that leads to detecting tax evasion. The failure of many distributors to provide the motor fuel registration number of their supplier or customer is a major impediment to computerizing the entire process of handling motor fuel returns.

More frequently, the Department is utilizing the possibility of cancelling registrations as a means of compelling compliance. If this fails to gain results, the Department may have to request legislation which would impose additional penalties on persons who fail to adhere to tax requirements ranging from failure to maintain records or file information reports to failing to complete invoices. The imposition of these penalties would not preclude the use of misdemeanor or felony penalties where serious abuse or an intent to evade tax was determined.

6. Continue to Develop and Encourage the Coordination, Cooperation and Exchange of Information Among the States, such as the Recently Passed Motion of the North Eastern State Tax Officials Association (NESTOA)

The Task Force recognizes that New York is not the only northeastern state faced with compliance problems relating to taxes on petroleum products. Each of the states has a common interest in accurately accounting for the amount of fuel imported from other states or conversely in accounting for fuel exported to other states.

In this respect, the Task Force strongly recommends an increased degree of cooperation and exchange of information among the states. It is expected that increased cooperation and coordination would help to increase accountability for fuel and aid in detecting bootlegging or tax evasion. In the long run such contacts among states could also result in more standardization or uniformity of information required by various states. This type of standardization should assist the record-keeping and reporting of distributors who conduct business and report to more than one state.

One example of such cooperation is the recent meeting of the Northeastern States Tax Officials Association (NESTOA), where the Commissioner of Taxation and Finance and other states tax officials discussed a pooling of resources. A task force was established to develop an automated reporting and reconciliation system for use in motor fuel tax administration by participating states. A second task force was created to evaluate the feasibility of cooperative tax enforcement programs among member states.

Another example, is to explore the possibility of computer assisted audits developed through the Northeast Motor Fuel Taxes Uniformity Group, a subcommittee of the National Association of Tax Administrators which includes members from the Department.

As a final example, the task force would point to the June 1984, Department-hosted Northeast Regional Conference of the Motor Fuel Tax Section of the National Association of Tax Administrators. Tax evasion in the northeast is one of the major topics for discussion at the conference. Industry and participating states will have the opportunity to exchange views on evasion and other areas of mutual concern.

The task force supports and encourages these and other efforts to improve the exchange of information among the states.

7. Establish a Confidential Departmental "Hot Line" Which Would Receive Information from Industry Personnel, as well as the Consuming Public, Where Situations of Petroleum Tax Evasion are Suspected

Information received through a "hot line" mechanism would be expected to identify potential areas for audit or surveillance.

The use of a "hot line" in departmental enforcement efforts is not new since this type of program has been in place for the Cigarette Tax Enforcement Program for years. The Department proposes to expand the current Cigarette Tax hot line to include reporting for all forms of petroleum tax abuse when increased enforcement authority and related organizational changes are in place.

Glossary of Terms

1. Registered motor fuel distributors --

    a. A "motor fuel distributor" is a person or business that imports or causes to be imported into the State for use, distribution or sale within the State, any motor fuel. Determining who must register as a distributor is governed by the point (instate or out-of-State) where title passes from the seller to the purchaser.

    Examples of who must register are:

    - A New York business picks up motor fuel from a New Jersey supplier. Title passes in New Jersey. The New York business must register as a distributor. (The above would apply even if the New York business were a filling station and the fuel were picked up in New Jersey by the New York business' own truck or a truck it hires, including common carriers.)

    - A New Jersey supplier receives orders for motor fuel from New York wholesalers and retailers. The New Jersey supplier delivers motor fuel to New York customers in its own truck. The New Jersey supplier must register as a New York distributor.

    - A New York business purchases motor fuel from an out-of-State supplier. The fuel is transported to New York via pipeline. The pipeline company does not own the product but does charge a transportation fee. If under the terms of the contract title passes in New York State, then the out-of-State supplier must register as a distributor. If title passes out-of-State, the New York purchaser is responsible to register as a distributor.

      NOTE: the pipeline company is acting as a transportation company (common carrier) and has no registration responsibilities.

    - Same circumstances as above, except the motor fuel is transported via barge owned by an independent company. If title passes in New York, the out-of-State supplier must register. If title passes out-of-State, the New York purchaser must register as a distributor.

2. Retail vendors -- Purchase diesel motor fuel in bulk and sell all or a portion of the fuel directly into the tanks of diesel-operated vehicles.

3. Bulk user -- Purchases in bulk and incurs a liability for diesel fuel used in whole or in part in vehicles under their control.

4. Truck operators -- Owners of diesel vehicles, other than passenger vehicles who do not have storage facilities of their own. Truck operators must pay diesel motor fuel excise tax to the supplier on all their purchases.

5. A "diesel motor fuel distributor" may be either a retail vendor, a bulk user or a truck operator.

   Examples of transactions which require registration as a diesel distributor:

   - Company A operates a service station and sells diesel fuel into the tanks of trucks and cars. A is a retail vendor and must register as a distributor.
   - Trucking Company B purchases diesel fuel in bulk and and uses it in its own trucks. B is a bulk user and must register as a distributor.
   - Company C purchases heating oil and sells it to residential customers. Even though diesel fuel and heating oil are of the same chemical composition, C does not have to register as a distributor.
   - Same situation as above except C uses a portion of the fuel to operate its diesel trucks. C is a bulk user and must register as a distributor.
   - Company D purchases fuel in bulk and sells a portion as heating fuel and the rest to a service station who will pump it into diesel vehicles. Company D does not have to register as a distributor. Company D must, however, file an information report MT-104.13 reporting the gallons sold to the service station who is a distributor.

6. Exempt Transactions -- Generally motor fuel and diesel motor fuel sold by a distributor for use other than on the highways or waterways of New York is not subject to motor fuel excise taxes. This includes sales for road building and other construction equipment, tractors and equipment for agriculture, and boats other than pleasure craft. Some sales are exempt depending upon the location where the title passes and still other purchases are exempt from tax even when the fuel is used on the highways.

   Specific exempt transactions are:

   -- sales between registered distributors

   -- sales by a registered distributor where delivery occurs out-of-State

- -- sales in bulk for immediate export from New York (provided the purchaser is a registered distributor in the state where the product will be exported)
- -- sales to the U.S. Government and New York State and its municipalities
- -- fuel sold to volunteer fire, ambulance and rescue squads

Farmers and contractors purchasing motor fuel in bulk or through retail outlets are required to pay the motor fuel tax and may apply for a refund or credit of the tax paid on fuel used off the highways. These refunds are claimed by filing Form TP-164.10, Motor Fuel Tax Refund Application.

If a nondistributor who has paid the motor fuel tax on purchases, makes a tax-free sale to New York State or the Federal government, he/she should apply for reimbursement of the tax paid by submitting Form MT-338, Record of Sales of Motor Fuel Without Tax. If approved, one copy of the form is returned to the nondistributor, who can present the form to his supplier for credit. The distributor, in turn, can take this credit as a deduction on his monthly return.

Farmers and contractors who do not have bulk storage must pay the diesel motor fuel tax to retail vendors and apply for a refund using a Diesel Motor Fuel Tax Refund Application, TP-164.4.

Governor's Task Force on Administration of Taxes on Petroleum Products and Businesses

Report 2:

Statutory Recommendations to Reduce Petroleum Tax Evasion

January 1985

GOVERNOR'S TASK FORCE ON ADMINISTRATION OF TAXES ON PETROLEUM PRODUCTS AND BUSINESSES

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EXECUTIVE SUMMARY

In November 1983, the Governor established a joint industry/government task force to propose solutions to the evasion of taxes on petroleum products and businesses and to evaluate and make recommendations regarding the economic impact of the petroleum tax structure in New York State. Because of the urgent and severe nature of the problem of tax evasion on gasoline, the Task Force decided to address enforcement and evasion problems before considering broader issues affecting the industry.

The urgent need for a legislative solution to the tax evasion problems increases daily for those in the marketplace who see:

- A significant loss of State and local tax revenues. The Department of Taxation and Finance is able to substantiate a $90 million loss annually. Industry estimates range as high as $200 million.
- Failures of legitimate businesses that elect not to engage in illegal activity.
- Increasing concern by petroleum suppliers about future investment possibilities in the New York market.

In April 1984, the Task Force submitted its first report to the Governor. It contained specific legislative and administrative recommendations aimed at correcting enforcement and reporting problems related to the avoidance and evasion of taxes on petroleum products and businesses. This report (Report 2) focuses on the structure of the collection of petroleum taxes as it relates to the evasion problem.

Currently, distributors are permitted to buy and sell gasoline from each other tax-free. Tax is ultimately to be collected on the sale of gasoline from a distributor to a non-distributor. Some distributors have devised various schemes which use tax-free sales to obscure audit trails and evade millions in taxes.

The Task Force has concluded that: (1) the State must increase both its enforcement powers and activities, and (2) the motor fuel tax structure must be reformed to impose or precollect taxes on the first sale of gasoline in the State and thereby eliminate tax-free interdistributor sales.

This report presents a proposal to collect excise and sales taxes on the first sale of gasoline made in the State. Under this proposal, the State 8¢ per gallon motor fuel excise tax and a uniform gallonage rate sales tax (at the average statewide sales tax rate multiplied by an average statewide retail price, computed quarterly) would be payable upon the first sale of gasoline in the State. The precollected tax would be passed through on subsequent sales until a sale to the ultimate consumer occurred. The ultimate consumer would be taxed on the actual selling price of the gasoline. The final seller would remit tax due or claim a credit or refund for overpayment. Tax paid by exempt organizations and governments would be refunded.

The advantages of this proposal are:

- The industry could compete in an environment less affected by price distortions caused by the evasion of taxes on gasoline;
- The State would collect most of its tax revenues at an early point in the distribution chain;
- Tax administration and enforcement would be simplified;
- Tax revenues should increase;
- Tax revenues to localities would be protected;
- Municipal Assistance Corporation (MAC) Bond covenants would be respected;
- Federal and State income tax deductibility of the sales tax on motor fuel would be preserved for consumers;

The disadvantages of the proposal are:

- Some distributors might lose a current cash flow advantage resulting from their access to the "float," which is the use of excise tax and sales tax revenues from the time collected until the time remitted to the State;
- Retailers, who were removed from the motor gasoline tax process, would again be responsible for remitting a portion of the sales tax on gasoline.

The evasion of taxes and bootlegging of gasoline are problems which have no easy solution. Under current law the State cannot effectively combat the evasion of taxes on gasoline. The enactment of both the first sale proposal in this report and the motor fuel and sales tax provisions contained in the Omnibus Tax Equity and Enforcement Act of 1984 are considered essential components of an overall effort. The enactments mentioned above must underpin increased audit and enforcement activities.

The bootlegging of gasoline into New York State results from the transportation of gasoline across state borders. The Task Force also urges Federal participation in solving this problem.

Appendix C contains dissenting opinions and additional recommendations on those issues for which a unanimous opinion could not be reached.

I. BACKGROUND

Annually the Department of Taxation and Finance collects over $1 billion from State and local taxes levied on petroleum products and companies. Most of this revenue comes from taxes on the sale or use of gasoline.

A. Summary of Taxes

Existing State taxes on gasoline include an 8¢ per gallon motor fuel excise tax on gasoline consumed on the highways and waterways of the State and a 4% statewide sales tax on the sale and use of gasoline. A ¼% State imposed sales tax is also applicable within the Metropolitan Commuter Transit District. In addition, a gross receipts tax of 2 3/4% is imposed upon "petroleum businesses" which import or cause petroleum to be imported for sale or use in the State.

The following local taxes imposed on gasoline also exist:

- A 1¢ per gallon excise tax on leaded motor fuel sold in New York City;
- A local sales tax of up to 4% (counties and cities in the State are empowered to enact State administered general sales taxes that parallel the State sales tax).

B. Revenue Losses and Fiscal Impact

Exact losses from evasion are difficult to quantify. Some estimates indicate that one gallon in ten escapes taxation; other estimates indicate a greater loss. Based on limited information required to be reported, the Department of Taxation and Finance has been able to document an annual loss of $75 million to the State and $15 million to localities. Some industry estimates of aggregate loss range as high as $200 million.

Tax evaders sell gasoline at a price below that of gasoline on which all taxes have been paid. This places the legitimate business which buys and sells taxed fuel at a competitive disadvantage, leaving some honest vendors of fuel (distributors, wholesalers and retailers alike) two choices: go out of business or, if they wish to remain competitive, sell untaxed gasoline.

C. Factors Contributing to Evasion

The Task Force found that large profits could be accumulated quickly from tax evasion, the methods of accounting for fuel or detecting abuse need improvement, and the available penalties for evasion provide little deterrence when compared to the illegal profits that can be made.

Statewide, an average gallon of gasoline is subject to State and local taxes of 18 to 20 cents which is as much as 6 or 7 times the usual profit margin. In the case of a single tractor trailer load (9,000 gallons) the illegal gain from tax evasion exceeds $1,500; a barge (1,000,000 gallons) generates approximately $150,000 in illegal gains. As distributors and wholesalers deal in millions of gallons per year, the attraction to evade taxes is obvious.

New York is an "importing state" with almost no domestic production or refining facilities. Annually, the State imports almost 7 billion gallons of motor fuels for consumption in the State. To ensure the proper payment of tax, the State must account for the fuel from the time it enters the State to the specific transaction where it is subject to tax. The current tax reporting system, however, is not adequate to account for these large volumes of fuel.

Complexities, inconsistencies and inadequacies in current law affect the administration and enforcement of taxes on gasoline. Penalties for evasion or noncompliance are weak or lacking altogether.

D. Types of Tax Evasion

Gasoline tax evasion in New York is usually perpetrated in a number of ways. Two of the most used schemes are:

- "Bootlegging" -- the importation of and failure to account for and pay tax on gasoline entering and sold within the State;
- The "daisy-chain" -- a succession of tax-free sales and erroneous recordkeeping and reporting used to avoid paying taxes and prevent authorities from detecting tax evasion.

Incentives for evading taxes exist because there is a disparity between state taxes on petroleum products. (see Appendix A). In addition, New York harbor is a major port for importing petroleum products into the United States (some 60% of the traffic in the Port of New York is petroleum-related). Many of these product movements are by individuals or companies with no nexus with New York. /1

In the opinion of the Task Force, passing the motor fuel and sales tax provisions contained in the Omnibus Tax Equity and Enforcement Act of 1984 is essential to reduce bootlegging in New York. This bill (A. 11701, S.9994) was introduced as a Governor's program bill in 1984.

A major means of evasion is the "daisy-chain" which typically involves a succession of tax-free sales of gasoline between registered distributors. Eventually, one or more of the transfers is concealed or made with tax supposedly included. In either case the distributor pays no taxes and gasoline reaches the consumer with no taxes remitted to the State. Figure 1 on Page 4 depicts a typical daisy-chain scheme.

In most instances, the lost tax revenues result in a lower retail price, which creates unfair competition for the honest gasoline retailer in the same market. In other instances, the "tax evader" pockets all the tax revenue and the price to the consumer is the same as the price of taxed gasoline.

There are numerous variations of the "daisy-chain" scheme. The complexity and ingenuity of each scheme is limited only by the imagination of the thief. Increasingly thieves are becoming more organized and sophisticated. Distributors may act in collusion with each other. Using "fronts" to act as corporate officers, one distributor may own and control several distributorships thereby controlling each of several transfers of gasoline. Even when taxpayers are legitimate businesses, tax-free transfers result in time-consuming and arduous audits.

E. Complexities in the Current Law

Before September 1, 1982 all vendors, including distributors, wholesalers and retailers, purchased gasoline free of sales tax. Most sales tax was collected by 10,000 retailers upon the sale to their ultimate consumers. Tax was collected in and reported for the jurisdiction where the sale was made to the

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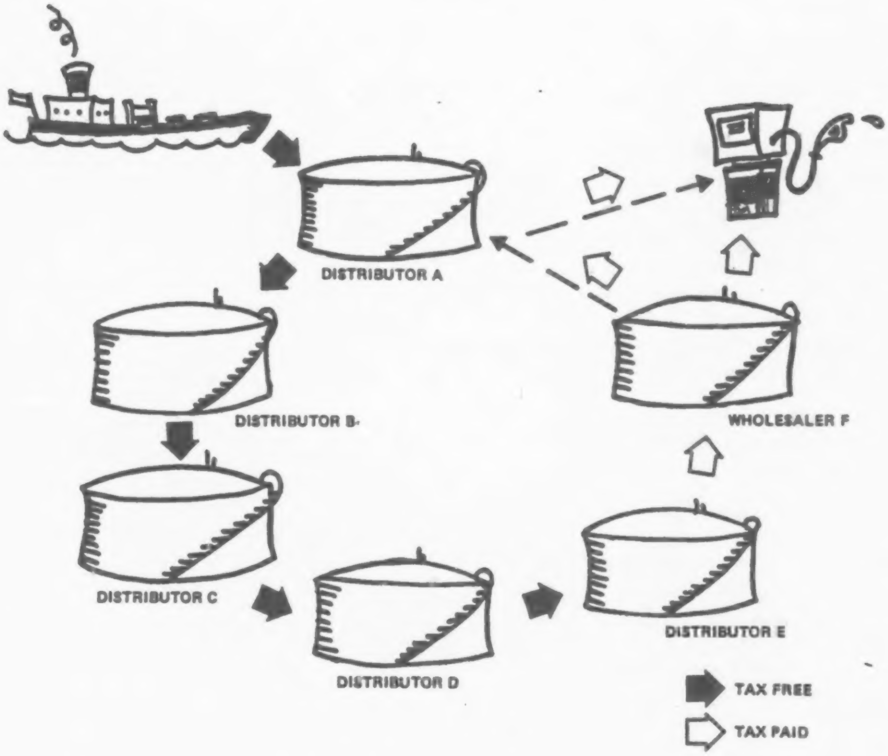
/1 A person has "nexus" with a state when its business activities have equalled or surpassed the judicially determined constitutional threshold of necessary minimum contacts with that state which are required before the state may impose burdens (ie, requirements to collect taxes, file returns, maintain records, etc.) upon any such persons.

FIGURE 1 - "THE DAISY CHAIN"


DISTRIBUTOR A
DISTRIBUTOR B
DISTRIBUTOR C
DISTRIBUTOR D
DISTRIBUTOR E
WHOLESALER F
TAX FREE
TAX PAID

- Fuel is imported tax-free by tanker or barge.
- Tax-free interdistributor sales are made from A to B to C to D to E.
- Distributor E sells tax paid to Wholesaler F.
- Wholesaler F subsequently sells tax paid to a retailer, who will eventually sell to the ultimate consumer.
- Evasion occurs when Distributor E fails to remit to the State the taxes due on the sale to Wholesaler F.
- The dotted line shows a more clandestine operation where Distributor A buys back the original fuel tax paid.
- By the time returns are due and the department traces transactions from A to B and so on, Distributor E is able to disappear or hide its assets, thereby drastically reducing the chances for collection.
- The above transfers may take place on paper only, with no physical movement of the fuel needed.

ultimate consumer. The amount of sales tax was based on the actual selling price of the gasoline and the combined State and local sales tax rate in the jurisdiction where the sale occurred.

In September 1982 and March 1983, the sales tax law was amended. The amendments changed the method for computing sales tax due and shifted the responsibility for collecting sales tax from 10,000 retailers to approximately 400 distributors. All sales of gasoline, except sales to distributors and certain exempt customers, were taxable. The premise of this legislation is that taxes can be more effectively administered and collected when the responsibility for collection is vested in fewer rather than many taxpayers and occurs earlier in the distribution chain. The revisions left unforeseen opportunities for abuse at the distributor level. It also added complexities to the law. The following are examples:

- A new method of computing tax was enacted, requiring a quarterly "regional average retail sales price" for four products for each of nine regions in the State (4 products X 9 regions = 36 separate prices used to compute State and local sales tax);
- A new system of collecting tax from automotive fuel carriers (AFC) based on certification and application of the highest rate in the AFC's marketing area;
- Certain large "commercial accounts" could elect to pay tax based upon the lower of (1) the actual selling price or (2) the regional average retail sales price.

Theoretically, shifting the point of taxation would change the locality in which the taxable sale occurred (for collection and distribution purposes) from the jurisdiction of ultimate sale to the consumer to the jurisdiction where the distributor sold to a wholesaler. The current law established a retail reporting mechanism to gather information and permit the distribution of State-collected local revenue to the jurisdiction in which the ultimate sale occurred.

Consumers and the petroleum industry have questioned the use of an artificial base (regional average retail sales price) for computing tax. Because tax is computed upon an average selling price, consumers buying from retailers selling below the average price are required to pay more tax than if tax were computed on the actual selling price. As a result of this artificial base, some consumers may pay a higher effective rate. Similarly, retailers selling below average must include in their price the same tax as those retailers selling at or above the average.

Some distributors cite the administrative burden and confusion of the current system. Each time a sale is made, the distributor must scrutinize each transaction to determine the jurisdiction of the sale, the region applicable to the sale, the type of fuel, and the combined State and local sales tax rate for the jurisdiction. The more variables involved, the more burdensome it is to administer, compute and collect the tax.

II. PROPOSAL FOR REQUIRING COLLECTION OF MOTOR FUEL AND SALES TAXES UPON FIRST SALE IN NEW YORK

The Task Force has conducted an analysis of the evasion problem and concluded that the State's power to impose penalties, require reporting, and conduct audits and investigations is not capable of controlling the entire evasion problem.

This problem, which is not limited to New York State, is occurring more frequently in many states. Federal, as well as state taxes, are being lost. Often fuel is imported from foreign countries or across state borders to evade taxes. A state's ability to monitor such shipments of fuel is very limited. Therefore, Federal participation in the motor fuel tax area, similar to that used successfully to combat cigarette bootlegging, is necessary. Federal assistance would not replace the State's efforts to combat the problem, but rather would contribute to a Federal/State partnership to deal more effectively with this multifaceted, multistate problem.

There are actions which New York State can take unilaterally to combat this problem. The Task Force finds that daisy-chain evasion is rooted in the abuse of various laws and long standing regulations which permit tax-free sales between distributors of petroleum products. The solution rests in eliminating such tax-free sales.

After studying various alternatives, the Task Force found that the most equitable and effective way of achieving such a result would be the collection of motor fuel tax and sales tax upon the first sale of gasoline in New York State. Accordingly, the Task Force recommends that:

> STATUTORY CHANGES MUST BE ENACTED TO ELIMINATE TAX-FREE SALES OF GASOLINE BETWEEN REGISTERED DISTRIBUTORS. MOTOR FUEL TAX AND SALES TAX MUST BE COLLECTED UPON THE FIRST SALE OF GASOLINE BY A DISTRIBUTOR IN NEW YORK STATE.

The Task Force has developed a comprehensive proposal which eliminates interdistributor tax-free sales, simplifies tax determination, and ensures the correct distribution of local tax revenues. The proposal includes elements essential to any tax law if it is to be equitable, enforceable and administrable. Accordingly, it has components addressing such factors as distribution of revenue to localities, recordkeeping, bonding, registration, invoicing, penalties, and other administrative considerations.

Under this proposal, the State 8¢ per gallon motor fuel excise tax and a precomputed uniform gallonage rate sales tax (at the average statewide sales tax rate multiplied by an average statewide retail price, computed quarterly) would be payable upon the first sale of gasoline in the State. The precollected sales tax would be passed through on subsequent sales until a sale to the ultimate consumer occurred.

The actual imposition and final collection of the sales tax on gasoline would remain at the consumer level. The vendor making a final sale would collect sales tax at the rate in effect for the locality where the sale occurs computed on the actual retail sales price. Sales tax would be distributed to the locality of final sale.

Such vendor (usually a retail service station) would be required to collect actual tax due from the customer and either (1) pay the Tax Commission the difference between the actual tax due and the precollected tax paid on purchases (i.e., that collected at first sale) or (2) claim a refund or credit for the excess of the precollected tax. [Under this proposal, retailers would again be responsible for remitting a portion of the sales tax. Alternative methods should be explored which could eventually remove this remittance responsibility from retailers. At some predetermined time subsequent to the enactment of this first sale proposal, the Department of Taxation and Finance and the Division of the Budget should be required to report to the Governor on the effectiveness of and continued need for retailer remittance requirements.]

Under the proposal for precollection of tax on first sale:

- Tax-free sales between distributors, and the opportunity that they afford for tax avoidance and evasion, would be eliminated;

- Those who "import or cause to be imported" would be required to be registered, licensed, and bonded. This would enhance auditing effectiveness. Department audit and enforcement efforts, freed from the often futile auditing of successions of tax-free (daisy-chain) sales, could concentrate on accounting for fuel entering the State;

- Some distributors who purchase fuel on which the motor fuel and precollected sales tax has been imposed may lose a current cash flow advantage which results from their access to "float". Float is the availability of tax revenues from the time collected until the time remitted to the State. To alleviate the potential economic hardship which may occur from losing float, legislation should be developed. This legislation should either provide a mechanism or give the Department of Taxation and Finance the ability to develop a procedure to address this problem. An example, for which there is precedent, is an extended payment mechanism. In 1982, retailers were granted this mechanism temporarily to permit them to adjust to prepaying tax on gasoline purchases;

- The use of a simpler uniform gallonage sales tax rate statewide would be permitted. This would remove the current confusion surrounding the many sales tax rates and bases on non-retail sales.

Several collateral benefits result from imposing a portion of the sales tax at the retail level based upon actual sales price to the consumer:

- Consumers would be required to pay, and service stations to collect, sales tax computed on the actual price charged for gasoline at the pump;
- As a result of the precollection of sales tax on gasoline at first sale, New Yorkers will continue to benefit from Federal and State personal income tax deductibility of State and local sales taxes on gasoline;
- It would improve the accuracy of the distribution of sales tax revenues to localities. Service stations would again be required to report collections of and remit sales tax on gasoline. Local distributions would be based on dollar sales (actual price and volume) in such areas. /2

A. Legal, Regulatory and Administrative Provisions of the First Sale Proposal

1. Tax To Be Collected Upon First Sale

Motor Fuel Tax -- Except where the first sale is exempt, such as a sale to the U.S. government, the 8¢ per gallon motor fuel tax would be collected upon the first sale of gasoline in the State.

Sales Tax -- The sales tax would be precollected on all first sales except where the first sale is exempt, such as sales made to U.S. government, or where the first sale is made to the ultimate consumer, in which case actual tax due

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/2 Under the system in effect since March 1, 1983, sales tax has been computed on average retail selling prices and local distribution has been based on information reports filed by service stations.

would be collected. Once paid, the precollected tax would be passed through to all intermediate purchasers and ultimately to those retail vendors selling to final consumers. The tax on a sale to an ultimate consumer would be computed on the actual selling price and the rate currently being imposed by the jurisdiction where the sale is made. Since most first sales would occur in those New York jurisdictions with major terminal sites, vendor collection and reporting of the tax on the ultimate sale or use of gasoline would ensure a proper and equitable distribution of revenues to localities.

2. Definitions

Sale -- Any transfer of title or possession or both of gasoline in New York State. This definition parallels that currently found in the sales tax law.

Exchanges of gasoline and consignment sales would be considered taxable transactions.

Taxpayer, Tax Collector -- For the purposes of tax precollection, the importer of fuel would be the tax collector. Similarly, the taxpayer with respect to the imported fuel would in general be the person purchasing from the importer. The following illustrations identify the tax collector/taxpayer under several circumstances. [3]

Illustration 1 -- A New Jersey supplier delivers gasoline in his own truck to a service station in New York. The New Jersey supplier is an importer and must collect tax upon its sale to the retailer.

Illustration 2 -- A New York distributor takes his own truck to New Jersey, purchases gasoline and returns the fuel to storage in New York. The sale occurs in New Jersey. The New York distributor is the importer. The importer must collect tax upon the subsequent resale of the gasoline in New York.

Illustration 3 -- An out-of-State supplier having no contact with or nexus in New York sells gasoline to a New York distributor. The fuel is shipped to New York via common carrier. A sale occurs in New York but because of the lack of nexus the seller cannot legally be required to collect taxes. The purchaser would incur a liability for the tax as of the date of purchase. Tax would be payable to the State within a predetermined period of time.

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[3] Also see item number 9, Retail Sales by Retail Vendors.

The above examples are for illustrative purposes only. The actual application of tax to specific transactions would depend on the results of the legislative and regulatory process. Appendix B provides other examples of the liabilities of purchasers and sellers in various circumstances.

3. Registration and Reporting

Only importers of gasoline (and all those causing gasoline to be imported) would be permitted to register as motor fuel excise tax distributors.

All persons or businesses selling gasoline in the State would be required to register as sales tax vendors. All sales tax returns from motor fuel excise tax distributors would be due monthly. Determination of the quarterly or monthly sales tax filing status of other gasoline sellers would depend upon sales volume.

The due date for motor fuel excise tax returns and sales tax returns would be the 25th of the month following the month in which the sale occurs. /4 These changes from the existing due dates would simplify reporting for distributors. While the consolidation of both returns into one may not be practical, the Department of Taxation and Finance should strive to simplify and consolidate forms and information requirements. In addition, sales tax and motor fuel tax provisions applicable to sales of gasoline (assessments, appeals, penalties, returns, secrecy, audits) should be brought into conformity when possible.

The Task Force recognizes that proper tax collection depends on the State's ability to account for all fuel imported and sold within its borders. In the absence of a regional reporting system, the Task Force urges that the Department

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/4 Currently, sales tax returns and motor fuel excise tax returns are due by the 20th and 27th, respectively, of the month following the month in which sales occur.

of Taxation and Finance be empowered to require recordkeeping and reporting from all persons buying, selling, storing or transporting motor gasoline, including but not limited to pipeline companies, common carriers, storage facility operators and independent inspectors of petroleum shipments. This reporting system must account for hundreds of thousands of individual transactions.

4. Bonding

Currently distributors may only be bonded for motor fuel tax liability. To protect the revenues due the State, all distributors must be bonded for motor fuel tax and sales tax. [The Department of Taxation and Finance will soon propose more stringent motor fuel tax bonding regulations.]

5. Invoices

With certain exceptions, such as gasoline sold by a service station directly into the tank of a car or into a gallon container, all sales of gasoline would be documented by a written invoice. The invoice would be required to separately state the number of gallons sold and provide a separate line item for each tax. Statements that "all taxes are included" would not suffice. All transportation of fuel would be required to be documented by a detailed manifest. The invoice for the sale of such gasoline would be required to include a detailed cross reference to the manifest.

6. Liabilities of Persons in Possession of Gasoline

There would be a presumption that all gasoline imported into the State (other than that in the operating tank of a motor vehicle) is subject to the taxes required to be precollected. Unless a business could show that it had paid the precollected taxes to its supplier or that it had imported the gasoline, it would be liable for the tax. An importer of fuel would: (1) have the obligations of a tax collector on the first sale of the gasoline or (2) accrue the tax on a use tax basis if it imported tax-free for its own consumption. Persons who fail to prove that they imported the gasoline or paid tax to their suppliers would be assessed accordingly. The Department would have the authority to assess taxes when the vendor was not able to account for discrepancies between product imported or purchased and product sold or in inventory. /5

7. Penalties

Severe penalties similar to those proposed in the 1984 Omnibus Tax Equity and Enforcement Act should be imposed for violations of Tax Law provisions affecting sales and motor fuel excise taxation of gasoline. Strengthened administrative, civil and criminal penalties are required for:

- Failure to collect or pay tax;
- Failure to charge and/or separately state tax on invoices;
- Failure to file returns, remit tax, or supply information;
- Failure to maintain records as required.

8. Pass-through of Precollected Tax

Once paid, the motor fuel tax and precollected sales tax would be required to be passed through to all intermediate purchasers and ultimately to retail vendors (those who sell to final consumers).

9. Retail Sales by Retail Vendors

Generally, a retail sale of gasoline would be defined as (1) a sale by a service station or (2) a sale to commercial accounts or bulk users.

At the time of the retail sale, the motor fuel tax and actual sales tax would be imposed. The motor fuel tax would be 8¢ per gallon and the sales tax would be based upon the actual price times the applicable State/local tax rate in the jurisdiction where the sale occurs. Retail vendors would claim a credit or refund where the aggregate tax paid pursuant to the precollection requirement exceeded the tax actually due. Conversely, retailers would be required to remit the difference where tax actually due exceeded precollected tax.

/5 In an interstate sale by a seller not required to collect tax (due to insufficient nexus), the purchaser would be required to pay tax directly to the Tax Commission.

10. Exempt Sales

With the exception of export sales discussed below and sales to the Federal government, all purchasers who currently buy tax-free would be required to purchase fuel with all taxes included. Organizations currently exempt under Articles 12-A, 28 and 29 of the Tax Law would claim a credit or refund.

11. Export Sales

All sales in New York for export would be exempt from the motor fuel tax and the sales tax upon submission of an export license certificate from New York State and proof of doing business from the State to which fuel is being imported.

Currently, distributors from other states may purchase gasoline tax-free in New York when they certify that the gasoline will immediately be exported for sale out-of-New York. Unless an export exemption is recognized within the first sale concept, these out-of-State distributors would have a competitive advantage over certain New York vendors who also export motor fuels. This would occur because the New York distributors would have prepaid the New York sales and motor fuel taxes, whereas the out-of-State distributors would not.

12. Transitional Provisions

Upon implementing the first sale proposal, distributors would have untaxed gasoline (that they imported or previously purchased tax-free) and tax-paid gasoline (purchased or received in exchange after the effective date of the first sale). In addition, retailers would be entitled to refunds where sales tax paid under the current system exceeds that actually due on sales under the new system. Some mechanism, such as a reporting and recordkeeping system that distinguishes between the two, would be needed to identify such gasoline and provide for proper tax liability.

B. Important Factors Affecting the Structure Of the First Sale Proposal

In addition to reducing tax evasion in the petroleum industry, the proposal for eliminating tax-free sales has been carefully constructed to preserve the basic integrity of the current law, particularly the sales tax law. Any proposal to change or alter the method of imposing sales tax must be carefully conceived to ensure proper distribution of revenue to local jurisdictions and to maintain the basic nature of the imposition as a sales tax (as opposed to creating an excise or other form of tax).

By precollecting the sales tax and imposing the actual tax upon the sale to the ultimate consumer, this proposal preserves the basic characteristics of a sales tax.

Several benefits result:

- State and local sales taxes on gasoline would continue to be allowed as a deduction for Federal and State personal income taxes. Currently, this deduction reduces the State and Federal tax burden for New York's residents by as much as $40 million annually.
- Under Municipal Assistance Corporation bond covenants, any event causing the erosion of the sales tax base may constitute a condition of default. Under this first sale proposal, sales tax revenues currently pledged as security and payment of MAC bonds are preserved.
- Sales tax would be distributed to the locality where gasoline is sold to the ultimate consumer, based upon the actual sale price and rate in effect in the locality.
- The tax paid by the consumer would be based on the actual retail price.

III. CONCLUSION

Despite the audit and enforcement efforts of the Department of Taxation and Finance, the evasion of taxes on petroleum products continues. Legitimate businesses are being harmed by unfair competition from businesses who sell untaxed fuel illegally. Because of the urgent and serious nature of this problem, action must be taken as quickly as possible.

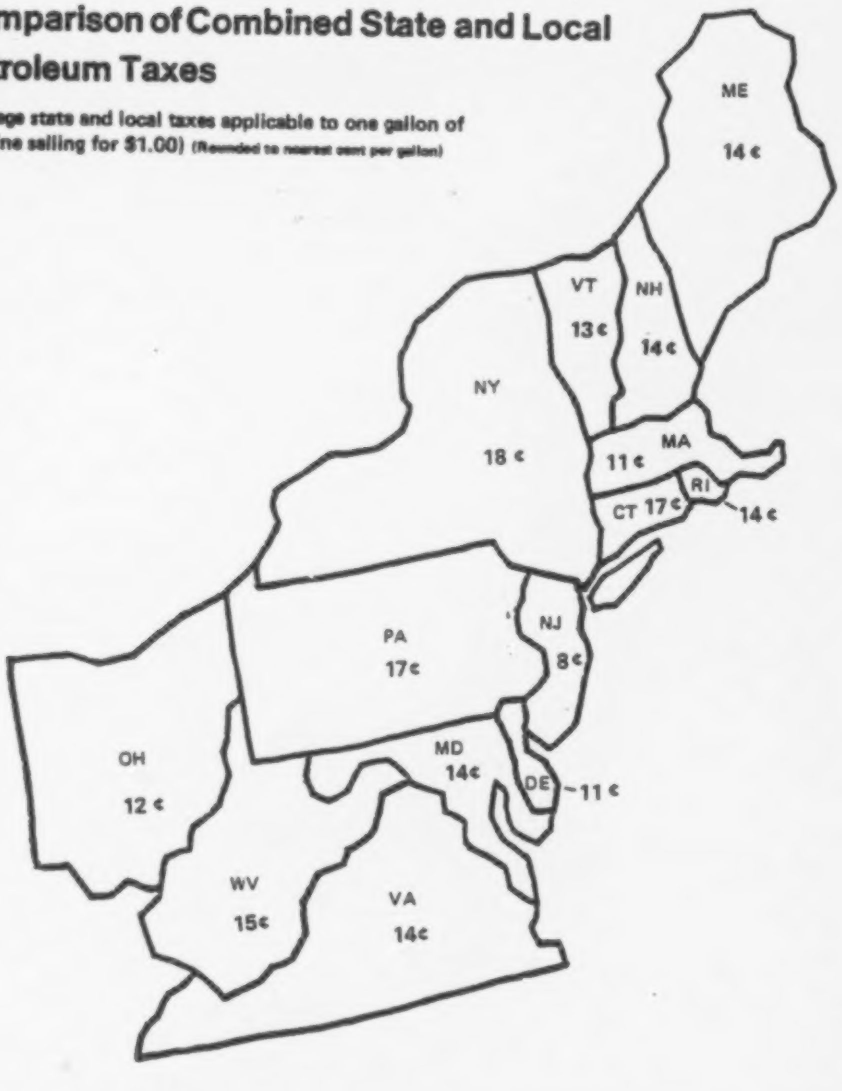
The current law does not give the Department of Taxation and Finance the authority to successfully control evasion and ensure the payment of taxes owed the State. Accordingly, the Task Force recommends the enactment of (1) the first sale concept contained in this report and (2) the motor fuel and sales tax provisions contained in the Omnibus Tax Equity and Enforcement Act.

The first sale proposal is not a panacea for gasoline tax evasion. In fact, it will only be effective when combined with the authority of motor fuel and sales tax provisions in the Omnibus Act and other actions. Other actions should include: sufficient Federal participation, enhanced State enforcement efforts, and computerization to enable the expedient use of information. All of these measures must be viewed as component parts of an overall effort aimed at reducing the losses attributable to the evasion of taxes on gasoline.

APPENDIX A

Comparison of Combined State and Local Petroleum Taxes

(Average state and local taxes applicable to one gallon of gasoline selling for $1.00) (Rounded to nearest cent per gallon)


ME
14 ¢
VT
13 ¢
NH
14 ¢
NY
18 ¢
MA
11 ¢
RI
14 ¢
CT 17 ¢
PA
17 ¢
NJ
8 ¢
OH
12 ¢
MD
14 ¢
DE
11 ¢
WV
15 ¢
VA
14 ¢

The above includes the combined generally applicable sales, excise, fuel, gross receipts or oil company taxes imposed by these states.

APPENDIX B

EXAMPLES OF IMPOSITION OR PAYMENT OF TAX UNDER THE FIRST SALE PROPOSAL

[The following examples are for illustrative purposes only. The actual application of tax to specific transactions would depend on the results of the legislative and regulatory process.]

EXAMPLE 1

Purchaser is a New York reseller with terminal storage (owned or rented) in New York.

Seller is a New Jersey supplier, doing business in New York and under an obligation to collect taxes.

Fuel is delivered from New Jersey as follows:

Delivery	Impact
A. New York purchaser picks up gasoline in New Jersey and transports to New York using his own truck, pipeline or barge.	A.- No tax due at time of sale. Seller has no obligations to New York at time of sale for this transaction. - Purchaser is an importer and must register (sales/motor fuel tax). - Purchaser must collect and remit motor fuel and "precollected" sales taxes upon first sale in New York.
B. Seller uses own truck, barge or pipeline to deliver to New York.	B.- Taxable sale. - Seller is an importer/tax collector. - Seller must register, collect and remit taxes. - Except upon sale to consumer, purchaser passes through "precollected" taxes on subsequent resale in New York.

Delivery	Impact
C. Common carrier (truck, barge or pipeline) hired either by the purchaser or seller delivers to purchaser terminal in New York.	C.- Same as B above. Seller is importer/tax collector. Purchaser is taxpayer.
D. Assume seller does not conduct business and has no nexus with New York. Gasoline is delivered to purchaser via common carrier (truck, barge or pipeline).	D.- Seller is an importer whom the Tax Commission has no authority to impose a collection requirement. - Sale occurs in New York. - Purchaser must pay tax directly to Tax Commission. - Taxes are due on date of import, to be paid at some predetermined reporting time. - Purchaser remits taxes (whether or not gasoline has subsequently been sold.
E. Same circumstances as B & C above (seller is under an obligation to collect tax). Assume seller fails to collect or indicate tax on invoice.	E.- Purchaser is obligated for the tax. - Tax is due upon time of delivery in New York. - Purchaser must remit tax within predetermined time frame. - Seller liable for penalty.

EXAMPLE 2

Gasoline is on a (common carrier) barge or tanker in New Jersey waters.

While in New Jersey waters, it is sold to a New York reseller.

The barge is directed to unload the fuel at purchaser's terminal (owned or rented) in New York.

- No tax due on sale.
- Purchaser is an importer and must register
- Purchaser incurs a liability upon first sale of fuel in New York.

Assume that purchaser owns more than one storage facility in New York. The purchaser transfers gasoline from one of its own storage facilities in State to another of its own storage facilities in New York, without transfer of title or sale to a third party.

- No taxable incident upon transfer.

EXAMPLE 3

Gasoline is in transit by barge or tanker.

While in New York waters, gasoline changes hands three times from Company A to B to C to D.

D directs that fuel be unloaded in New York at storage tanks owned or leased by D.

- Sales from A to B, from B to C, and from C to D occur in New York; and are therefore events subject to precollected tax.
- Company A must precollect taxes from B.
- Company B would pass the precollected taxes on to C, in similar fashion C would pass the precollected taxes on to D.

EXAMPLE 4

Company A maintains inventories of gasoline in New York and New Jersey. Company A directs that gasoline from its Jersey facility be transferred to its New York location(s). Fuel is transported via common carrier (truck, pipeline, tanker).

- No taxable incident.
- Company A is an importer
- Company A must register
- Company A must collect and remit tax upon its first sale in New York.

What would the effect be if Company A transported the gasoline to New York in its own trucks?

- Same as above

EXAMPLE 5

A New York retail service station orders fuel from a New Jersey supplier. Fuel is delivered to New York by seller's truck or common carrier. Seller fails to collect or separately state tax on invoices.

- Retailer is under an obligation to pay the tax.
- Retailer must file a return and remit 8¢ motor fuel and an amount equal to "precollected" sales tax within predetermined time (whether fuel has been resold or not).
- Retailer sells fuel at retail pumps - collects 8¢ motor fuel and actual sales tax based on actual price and rate in locality.
- Files sales tax return, takes credit or pays difference between precollected sales tax and actual tax due.

Would the retailer's obligations be different if the fuel had been purchased from a New York supplier who failed to collect tax?

- No the retailer is obligated to pay tax on the transaction.

EXAMPLE 6

Companies A & B are major suppliers, both of whom are registered importers in New York. Both maintain inventories in New York, Texas, and Ohio.

a) A permits B to draw gasoline from A's inventory in Texas; B permits A to withdraw an equal amount from B's Ohio storage.

  - No New York tax responsibilities.

b) A permits B to draw gasoline from A's inventory in New York in exchange for a reciprocal agreement to withdraw fuel from B's Texas storage.

  - New York taxable event.
  - A has sold fuel to B in New York.
  - A is required to collect tax from B (pass-through if tax has already been precollected).

EXAMPLE 7

Company A is a registered New York importer/distributor.

Company A has a tax-free inventory (in New York).

Company A consigns fuel to Company B in New York.

Company B sells fuel to Company C, a retailer in New York.

- The initial transfer of fuel from Company A to Company B is subject to tax.
- At the time of Company A's consignment to Company B:
    1) Company A is obligated to collect 8¢ motor fuel and precollected sales tax from Company B.
    2) Company B passes taxes through to Company C.
- Company C collects taxes based on actual sales price and locality,claims credit or pays difference between precollected taxes and actual tax due.

EXAMPLE 8

Company A is a registered importer in New York.

Company B is a New York jobber with an inventory of tax-paid gasoline.

Company C is a retail service station customer of Company A.

Company A enters into an agreement with Company B - whereby Company B will deliver gasoline to Company C on behalf of Company A.

Company C receives its billing from Company A.

- A sale of gasoline occurs between Company B and Company A. Company B passes through the precollected tax to Company A.

- Company A passes the precollected tax through to Company C.

What changes would occur if Company C were the U.S. government?

- Company A must sell tax-exempt.

Assume that Company B were an importer with a tax-free inventory.

- Net effect basically the same except instead of Company B passing precollected tax through to Company A it would be required to collect tax from Company A.

- Company A must pass through the tax. If the sale is to the U.S. government, however, Company A must sell tax-free and apply for a credit or refund.

EXAMPLE 9

Company A is a registered importer with a tax-free inventory.

Company A sells gasoline directly to an exempt organization.

- Company A must collect tax from the exempt organization other than the U.S. Government.
- The exempt entity may apply for a refund or credit for the collected tax.

EXAMPLE 10

Same as above, but Company A sells to U.S. government entity.

- Sale is tax-exempt.

Assume sale is made to government by a wholesaler or retailer who has prepaid the tax.

- Wholesaler or retailer would sell to the government tax exempt.
- Wholesaler or retailer may apply for a refund or credit.

APPENDIX C

STATE OF NEW YORK

ADDITIONAL VIEWS AND RECOMMENDATIONS - NEW YORK STATE DEPARTMENT OF TAXATION AND FINANCE AND NEW YORK STATE DIVISION OF THE BUDGET

The Department of Taxation and Finance and the Division of the Budget strongly support the elimination of inter-distributor tax-free sales and the first sale concept. However, there are aspects of the proposal as presented in this report to which the Agencies take exception. In addition, the proposal should be supplemented by a comprehensive accountability system to account for fuel entering the State.

I. Proposed Registration and Bonding Requirements

To obtain permission to become or retain status as a registered distributor, all businesses should be required to pass an established set of guidelines.

These guidelines should consider various factors including business activity (importation, nonimportation), financial stability, prior tax reporting and payment history, and character and competency of responsible controlling officers, shareholders and employees.

The evaluation of these factors would assist not only in determining the amount of a bond to be required but also whether the business should have or continue to have permission to be a distributor.

II. Export Sales

Tax enforcement and compliance is enhanced when tax-free sales are eliminated. The first sale proposal embraces this basic concept. Accordingly, all sales in New York for export should be taxable. Exporters would subsequently be entitled to refunds or credits of taxes paid upon submission of proof that fuel had been exported and accounted for in another state. If export sales were taxed, out-of-state distributors would be in the same competitive situation as New York vendors who would be required to prepay the tax under the first sale proposal.

The Task Force's opinion is that all sales in New York for export should be exempt. The Agencies believe that this would provide an opportunity for faulty reporting and tax evasion. Businesses evading New York taxes are or could become distributors in other states. Depending upon the laws in the other states, the product could be erroneously accounted for on the tax returns of the other state, and sold in New York without the payment of either State's taxes. Where there is a differential in tax rates between New York and the other state, some purchasers might pay the other states tax to give the exportation all the appearances of a legitimate transaction. In reality, the fuel could be sold to retailers in New York without being exported or having New York taxes paid.

By requiring the payment of tax "up-front," an opportunity for evasion is eliminated and the Department is in a stronger position to audit and subsequently initiate collections resulting from improper export sales. These same elements of tax-free purchases, followed by auditing, determination of tax liability, assessment and collection after the fact are inherent problems in the current daisy-chain evasion schemes.

The Department of Taxation and Finance and the Division of the Budget recognize that some out-of-state distributors may elect to purchase in other states rather than buy in New York and prepay tax. The potential loss of business to New York appears to be outweighed by the benefits to be derived from reducing tax evasion.

III. Conformity of Return Due Dates

Part II, Section A (3) titled Registration and Reporting recommends changes to due dates of motor fuel tax and sales tax returns. These returns are due respectively on the 27th and 20th of the month following the date in which sales occur. The report recommends consolidating the due dates for both returns on the 25th of the month. The changes would purportedly simplify reporting for distributors.

A common reporting date is desirable. The Agencies also support attempts to simplify, consolidate and standardize as many forms, requirements and administrative provisions of the two laws as possible. The Task Force is urged to reconsider its position in the issue of consolidating due dates on the 25th of the month.

The Department is required to distribute sales tax revenues to localities by the 12th of the month following the month in which returns are filed. This is an arduous task requiring the prompt and accurate processing of over 300,000 returns which are filed at the end of each quarterly filing period. Changing the sales tax due date for only one segment of the sales tax vendor population will make efficient administration of the sales tax program extremely difficult. It will be extremely burdensome and costly for the Department to meet its statutory mandate if the due dates for this industry are moved to the 25th of the month. The vast majority of vendors will be required to file and remit taxes on the 20th. Motor fuel distributors, on the other hand, would be given an additional five days.

Any delay in promptly receiving or processing returns would result in significant lags in distributing proper revenues to localities which impose local sales taxes. Moving the due date to the twenty-fifth would also result in a delay in the State's receipt of sales tax revenues from gasoline sales.

The Agencies recommend that the filing date for sales tax returns remain on the twentieth and that the motor fuel tax filing date also become the 20th. Both the Industry and the State would benefit from the simplicity of filing returns on the same date, yet the problems previously cited would be eliminated. As sales tax returns are presently required on the 20th, the requirement that motor fuel returns also be filed on the 20th should present no accounting or recordkeeping difficulties for the industry since in most instances the sales and/or gallonage accounted for on each return are similar. It should be noted that the motor fuel tax return for February sales is now due by March 20th.

IV. Control of Petroleum Imports

The Agencies endorse actions (State or Federal) to enhance its ability to account for fuel imported or sold in the State. Within the limits of its current authority, the Department has expanded the information available from independent parties, such as transporting or storage facilities, and has improved systems to make better use of information. It has also encouraged Federal assistance in providing data necessary to enforcement and accountability. These actions and the Task Force proposals in this area, however, are only a first step toward implementing a system of total accountability which also ensures revenues due the State.

Traditional reporting and accounting systems put the Department in a position of reacting to transactions which occurred weeks or months prior to their being detected. Often by the time such information identifies abuses, a distributor has been able to incur large unpaid tax liabilities and go out of business or hide assets beyond the reach of tax collectors. The liabilities incurred are often far in excess of the bonds held to secure payment of tax.

The first sale proposal will ease the Department's burden of determining when taxes become due. Instead of tracing a succession of daisy-chain sales to the point of taxable incidence, tax incidence will be more easily identified since it occurs either when the act of importation results in a sale in the State or upon the importers first sale of the product. The Agencies strongly endorse the first sale concept. Tax collections and administration however, would be enhanced even further if it were complemented by an improved accountability system.

The Department should have the authority to implement a comprehensive fuel monitoring system capable of identifying petroleum product prior to or concurrent with its importation. The system should include a series of checks and balances whereby information from third parties is capable of substantiating information from distributors. A mechanism should also be devised that results in prompt detection of abuses, the prompt cancellation or suspension of the distributor's importation privilege and ensures that bonds and other guarantees of payments are sufficient to meet motor fuel and sales tax liabilities. Strict administrative, civil or criminal penalties should be imposed for failure to adhere to the provisions of the Tax Law. Where certain enumerated activities suspected of or relating to evasion occur, the Department should be empowered to take immediate enforcement action.

Below is the basic framework of one possible system to account for fuel and secure greater tax payments. The system demonstrates the types of components which may be necessary. The benefits of any system must be carefully weighed against any disruptive effect or burden which may be placed upon the industry. Accordingly, the views and opinions of industry will be sought in order to develop the most effective system possible.

Conceptual Design of an Accountability System

-- Under this system a transaction control number would be assigned by the Department of Taxation and Finance to each shipment of motor gasoline imported into New York State. Prior to any shipment entering the State, including any of its navigable waterways, registered distributors importing fuel would be required to furnish to the Department the seller's name, address and identifying numbers; the type and quantity of product being shipped; the purchasers name, address and identifying numbers; the designated delivery point (terminal, etc.); and the transporters name (For this proposal, a transporter would include but not be limited to any pipeline, barge, tanker, trucking or other company or conveyance.), address and identifying numbers. Upon receipt of this information a control number will be assigned by the Department.

-- The distributor will be required to provide this control number to the transporter prior to shipment of the fuel into New York State. Before entering the State, the transporter will be required to contact the Department and provide specific information regarding the shipment including identity of the shipper, destination, type and quantity of fuel and identity of the recipient of the fuel. In addition, the transporter will be responsible for insuring that the control number appears on all delivery documents.

-- To complete the cycle of accountability, immediately upon receipt or delivery, the terminal or other recipient would notify the Department of such delivery including control number, quantity and type of fuel received, consignee (if applicable) and any other information determined to be necessary.

-- To provide total accountability, the Department would be made aware of all movement of untaxed fuel within or through the State. Therefore, in addition to receiving importation data, the proposed program including control numbers and importer, buyer, seller, transporter or storage facility reporting would apply to fuel shipped through the State for delivery outside the State, fuel shipped from a point within the State to a point outside the State, and all fuel delivered within the State to municipalities or other nontaxable purchasers.

-- To minimize the impact of this proposal on the efficient fuel distribution system currently in place within the State, 24 hour service would be maintained with the Department to assign control numbers and receive the information required of distributors, transporters and terminal operators. Computer terminal access may also be considered. If required, a follow-up information return procedure would also be adopted.

-- Specific administrative, civil and criminal penalties would be provided to insure that all desired information is furnished by importers, transporters and terminals and that all taxes are paid to the Department within the required time periods.

-- As an adjunct to the outlined reporting system, new bonding limits and procedures would be established for registered distributors. Every distributor importing fuel into New York State for sale would be required to post a bond sufficient to insure the payment of motor fuel and sales tax which would be due on the fuel normally imported during a thirty day period. The amount of the bond would establish a "line of credit" against which the control numbers would be issued.

-- When a control number is issued to the distributor, an appropriate "charge" against his "line of credit" would be made for the State taxes calculated to be due on the specified shipment. Each subsequent request for control numbers would be treated in the same manner until the distributor had reached the limit of his "line of credit."

-- No further control numbers would be issued, and no shipments into the State permitted, until the distributor documented that fuel was sold in an exempt manner, paid the taxes due on authorized shipments thus reestablishing his "line of credit," or posted additional bonding to increase the "line of credit." If a distributor is to be permitted to continue to import within New York State, all taxes due on shipments into the State must be paid within thirty days of the issuance of the control number whether or not the limit of his "line of credit" has been reached.

This conceptual plan would help to insure that New York receives the proper taxes due on motor fuel sold within the State. The only fuel permitted to enter the State would be that upon which the tax liability has already been satisfied or that where the potential liability is secured by bond unlike the current situation where, because of reporting delays, a distributor's potential liability at any point in time may substantially exceed the limit of his bond.

ESPA
EMPIRE STATE PETROLEUM ASSOCIATION, INC.
8 WESTCHESTER PLAZA • ELMSFORD, N.Y. 10523 • 914-592-8810

DISSENTING OPINION
ON REPORT
BY THE
GOVERNMENT/INDUSTRY TASK FORCE
ON PETROLEUM TAXES

Empire State Petroleum Association (ESPA) opposes the acceptance of this Second Report because it is inadequate and misdirected. The Report fails to deal with import bootlegging, the root cause of motor fuel tax evasion. Its principal recommendation will not achieve anticipated tax revenues. If this proposal is accepted, small New York owned and operated businesses and the communities they serve will be needlessly injured.

The Task Force's first draft in October set forth the following practical criteria for restructuring and administration of petroleum taxes:

> 'In developing a proposed legislative solution care was taken to ensure that 1) the proposal achieved the desire effect and 2) that the construction of the proposal does not inadvertently create more unforeseen problems than it proposed to solve.'

The Second Report fails to meet the Task Force's own guidelines because its proposal will not eliminate bootlegging and will create other disadvantages.

The initial Report to the Governor correctly identified the problem and focused on the avoidance and underpayment of taxes on motor fuel, primarily on "bootlegging" by non-reporting or faulty reporting as a key objective. However, this Second Report brushes aside the unsolved bootlegging evasion, and instead, attention is shifted to interdistributor sales. The Report proposes to overcome some Tax Department auditing and administration problems by the elimination of the historic 12-A classification of several hundred independent New York wholesale petroleum importers. The Report acknowledges, very briefly, the "significant consequences for cash flow" ... for petroleum distributors, but then fails to resolve the disruptive impacts of wholesalers traditional business relationships with their banks and oil suppliers. Worse, the Report admits its drastic proposal eliminating traditional interdistributor sales "will not be an all encompassing solution to the evasion problem."

Important omissions in the Second Report may well mislead interested policymakers. The widespread evasion of the 13-A Gross Receipts Tax on petroleum products is totally ignored. Bootleggers continue to evade this tax eventhough it is a first sale assessment and presented as a solution in the Second Report. There is little justification for shifting motor fuels excise and sales tax collection to the first sale when the Tax Department has been unable to assure collection of the Gross Receipts Tax at that level. New York will never solve petroleum tax evasion until it has knowledge of the volumes being imported into the state. It doesn't know now. Overcoming this fatal weakness should have been a high priority of our Task Force, yet is scarcely mentioned in the Second Report.

The Tax Department takes the position that it cannot be expected to track 20-30 interdistributor sales transactions, and are thus prevented from eliminating tax evasion. This recalls the vision of a harried person trying to eliminate flies in the kitchen with a hand swatter while leaving the door open. The open door is import bootlegging. The flies are the bootleggers, and some of them do disguise themselves by limitless transactions - the so called "daisy-chain." This report centers on the daisy-chain rather than closing the door to import bootlegging. The remedy to the daisy-chain advanced by the major oil companies ad hoc group is to eliminate the traditional tax-free exchange status of independent New York wholesalers. This would be accomplished by the imposition of taxes on the first sale.

Ironically, the major oil companies have firmly and successfully resisted ESPA's longstanding demand that the Tax Department mount a concentrated effort to close the bootleg door by zeroing in on petroleum Gross Receipts Tax, which is a first sale collection already in the law and due directly from the oil importer.

ESPA believes these valid objections have not been adequately addressed and the Report's primary recommendation will cause more harm than good. ESPA has fought longer than anyone else in seeking petroleum tax restructuring that would eliminate tax evasion and its anti-competitive effects that are victimizing legitimate distributors. ESPA is also aware of the need by the regulatory agencies, the executive branch and Legislators for industry "consensus" on effective measures which avoid serious negative effects.

To achieve such a consensus ESPA offered a compromise to the Tax Department which would eliminate their difficulties in tracking 20-30 transactions without disenfranchising legitimate wholesale businesses. ESPA proposed to sharply limit tax-free transfers - the 2nd sale concept. This would quickly eliminate any daisy-chain auditing problem while retaining 12-A status and necessary operating flexibility for wholesale importers.

In July the Tax Department replied they still preferred the first sale concept, eliminating distributors 12-A tax status. No meeting of the Government/Industry Task Force was ever called to discuss the ESPA compromise, nor was it even mentioned in the October 1st draft. Despite objection by ESPA on October 15th, the compromise offer is still ignored in the Second Report to the Governor.

In the November 27th Task Force Meeting ESPA again appealed for consideration of the second sale approach, allowing the Task Force to propose recommendations with unified industry support, but our call for unity was rejected.

Apparently the view was that there were sufficient votes for elimination of the distributors 12-A status. This would be a misleading application of the term "consensus." ESPA was accorded only a single vote in the Task Force though it represents hundreds of independent wholesalers who are relied on to supply motor fuels to every part of our state and are the industry segment most affected. By comparison, major oil companies were given four of the nine industry votes. They represent approximately 18 refiners, many of which no longer operate in large sections of New York state.

While all refiners stand to benefit financially from the first sale proposal they advocate, several have expressed strong reservations about the disruptive financial impact of the proposed report on their wholesale customers' ability to continue in business. And, a few large ESPA members believe they too may benefit financially from the first sale approach, and support it. However, by actual number of oil companies involved and volumes delivered there is a broad industry consensus opposed to the proposal, not in favor as the Report implies.

ESPA recognizes the need for greater enforcement capability and supports the recommendations in the First Report to the Governor last April - such as raising certain misdemeanors to felonies; impounding trucks and vessels; holding corporate officers personally liable; requiring statements of taxes paid; reviewing changes in a petroleum company's entity, or officers; and, added authority to examine storage and transportation in possession of taxable fuels.

Administratively, more could be done to complement the enforcement effort. Publication of the list of licensed distributors has yet to be done. The approach to federal authorities has been too slow. No resolution for unified regional action was proposed at the recent Northeast Tax Administrators Conference, and the confidential "Hotline" does not appear to be functioning as it should.

As to petroleum tax restructuring, ESPA will propose an alternative built upon the 2nd sale concept - one that maintains effective mechanisms already proven by experience, and avoids further disrupting the current precarious financial position of many distributors. The objective will be to provide law enforcement with a single audit trail and a basis for determining an instant crime with accompanying stringent penalties.

12/10/84

Chairman PICKLE. Thank you, Mr. Chu. You said we should give some special attention to our international borders such as Canada. You do not mention Mexico. With regard to Indian reservations, is gasoline being funneled through them?

Mr. CHU. We have some evidence, to evade State tax.

Chairman PICKLE. Thank you.

Mr. Barger.

STATEMENT OF STEPHEN J. BARGER, JR., CHIEF, BUREAU OF AUDIT SELECTION, FLORIDA DEPARTMENT OF REVENUE

Mr. BARGER. It is with great pleasure that the Florida Department of Revenue finds itself here today before the Subcommittee on Oversight to testify about gasoline tax enforcement efforts by State and Federal Governments, and Mr. Chairman, I submit for the record our nine page prepared testimony and will summarize our testimony at this time.

Presently, Florida imposes the State excise tax at the wholesale level.

The first component is a 4-cent per gallon excise tax and the second component is a sales tax based at 5.7 cents per gallon. Both taxes act as an excise tax and are enforced under the State law in the same manner. The point of taxation in Florida is at the first sale after import into the State.

The first sale does not include sales between refiners or first sales to wholesalers of product by an importer or refiner. It is interesting to note also Florida law allows local governments to impose local option fuel taxes at rates ranging from 1 to 7 cents per gallon. Total tax rate per gallon in Florida may be as high as 16.7 cents or as low as 9.7 cents per gallon depending upon the geographic location in which the product is sold.

Estimates of Florida's tax losses during 1982–84 period were reported by the media to be in excess of $200 million.

This figure included estimates of Federal tax losses as well as the State tax losses for both New York and Florida. In no event should Florida's tax loss from the 1982–84 tax schemes, as was testified to by your first witness this morning, exceed a total of $10 million in tax.

Penalty and interest could be added to that to escalate the figure. At this point in time, tax auditors in Florida do not perceive that the tax evasion has grown, especially in terms of organized crime involvement from out of State. We have experienced an increase in tax fraud cases relating to local role players. Recently 6 companies were found by the statewide grand jury to be involved in gasoline tax fraud schemes and 15 people connected with these firms have been indicted and arrested. Virtually all of our problems have been located south of a line that could be drawn from Tampa to Orlando and eastward to Vero Beach.

Further that criminal activity was skewed to the extreme east coast portion of our State. The very large population area, Mr. Chairman, where there is a very high activity in motor traffic.

By and large, all organized tax evasion schemes work through a company which is known to enforcement officials as a bust out or a burn company.

This company, a duly licensed, permitted or registered company, is a shell through which only paper flows.

I have attached and marked as exhibit B several schematic diagrams of daisy chain operations known to have existed in Florida. The newer local forms of tax crime appear to range from crude imitations of the more sophisticated schemes employed by organized crime to unilateral conversion of taxes collected by a taxpayer who is experiencing difficult economic conditions.

I might add that that particular portion seems to coincide with the information previously delivered by testimony.

Key among the provisions of Florida's new law which became effective January 1, 1986, is a section which permits the Department to conduct background checks on all licensed applicants. A second key to stemming tax fraud is found in the detailed product reporting requirements of our new law. Heavy penalties are also a part of our new law and administratively the Department is staffing to reduce the time threshold between the receipt of the return and contact with a taxpayer should a return error occur.

Further audit coverage has been increased. Results are easy to measure. We have denied six license applications this year. Return quality has improved.

Audit assessments have increased from 142 during the first 9 months of the State fiscal year ending 1985 totaling $3,800,000 to 246 assessments for the identical period this year totaling $6,600,000.

Voluntary remittances also have experienced a positive percent change, Mr. Chairman, of 5.4 percent the first 10 months of the State fiscal year 1986 over the same period for State fiscal year 1985.

Finally, Florida is heavily committed to a uniform schedule of report form. The form is under the auspices of the National Association of Tax Auditors and being considered by every State in the Nation, including the District of Columbia. Industry is also heavily committed and involved in this program.

Florida has had a 30-year history of mutually beneficial relationship with the IRS. The agencies entered into an implementation agreement involving motor fuel tax audit changes in 1983 and in 1985 began sharing the information on a routine basis.

The first 6 months this year we have sent 129 agreed audit changes to the excise tax group in Fort Lauderdale and they involve 45 business entities, 14 of which were gasoline tax audits, the balance were diesel fuel tax audits. On the receipt side, Mr. Chairman, we have received 13 gasoline tax audit reports from the excise tax group located in Fort Lauderdale.

Because the point of taxation for State taxation differs from the point of taxation at the Federal level, it is not possible for our personnel to estimate the Federal loss attributable to untaxed sales in Florida.

State revenue personnel are not aware of any specific proposed solutions to the Federal excise tax compliance problem, or were not aware until the hearings this morning. However, it would seem reasonable to assume that one proposal would be to relocate the point of taxation to the place of import, in the case of foreign fuel, or to the point of production of domestic fuel. Should this be the proposal we can speak with some confidence as to the reaction of industry.

Florida's original 1985 draft law taxes fuel on the first import into the State. As previously discussed, the State now taxes fuel on its first sale, which is one step down the distribution chain. The amendment to move the point of taxation was a direct result of industry voicing their concerns over cash-flow, increased product costs and extended time periods over which they must wait to make collections of their front end tax expenses. These concerns will also be voiced at the Federal level by the middleman suppliers that form the main link in the fuel distribution network.

Florida, more than any other State, except perhaps New York, has been directly involved with the Internal Revenue Service in the matter of fuel taxes since early 1985. Our personnel have had an opportunity to review the Federal fuel tax reporting and administrative programs and to talk to high-level Service personnel regarding mutual tax evasion problems.

It is our recommendation that the improvements needed to correct the apparent excise tax compliance problems are twofold: Improve the report requirements by requiring on IRS form 720 an accurate accounting of product bought and sold; and by eliminating the exempt purchase privilege allowed by qualifying as a producer on form 637, section J.

Chairman PICKLE. I must interrupt you and I am sorry. We have a vote on and I have only a few minutes to get to the floor to record a vote. The committee will have to stand in recess for approximately 10 minutes.

[Recess.]

Chairman PICKLE. The committee will come to order.

We apologize for the interruption, but these votes do occur. We were receiving testimony from Mr. Barger, who had finished or almost finished his testimony. Do you have any additional statements, Mr. Barger?

Mr. BARGER. Yes, Mr. Chairman.

Florida, through people like myself, have been involved in working with other State governments and with the IRS in an effort to upgrade the collection systems and personnel to eradicate tax crimes of the nature spoken about today.

Mr. Randy Miller, my executive director, has pledged his 100-percent support of improvements to the Federal excise tax collection system and is offering to this subcommittee to the Committee on Ways and Means, and to the Internal Revenue Service our Department's cooperation to the highest degree.

Mr. Chairman, this concludes the prepared testimony. Thank you.

[The prepared statement follows:]

Statement of Stephen J. Barger, Jr., Chief, Bureau of Audit Selection, Florida Department of Revenue

Mr. Chairman, members of the Committee, Committee Counsel, and staff, it is with great pleasure that the Florida Department of Revenue finds itself before the Subcommittee on Oversight to testify concerning gasoline tax enforcement efforts by both the State and Federal Governments within the State of Florida.

The outline given to the department over the Chairman's signature and dated June 25, 1986 addresses seven major issues of tax administration. Within these several issues are multiple follow up questions that expand upon the areas of primary concern relative to motor fuel tax enforcement. These remarks will follow the suggested format.

1. Presently Florida imposes the state excise tax at the wholesale level. Our law, known as Chapter 206, Part I, Florida Statutes, was completely rewritten in 1985 as a result of tax evasion schemes which were uncovered during the latter portion of calendar year 1984. Prior to the redrafting of the law, Florida had a liberal tax pass-on provision. The new law moved the collection point of the State's excise tax up the distribution chain and it is now closer to the point of import. Florida's law recognizes real life situations within the industry. The 1985 law which became effective January 1, 1986 requires the licensing of Refiners, Importers, Wholesalers, Jobbers, Retail Vendors, Terminal Facilities and Carriers. Reports of product bought, sold, stored or transported are required from each licensee. The point of taxation in Florida is at the first sale after import. First sale does not include sales between Refiners or first sales to Wholesalers of product by an Importer or Refiner.

It is interesting to note that Florida law does allow local governments (Counties and Municipalities) to impose Local Option fuel taxes at rates ranging from 1 to 7 cents per gallon. These taxes are collected by the Retail Vendors of gasoline and are remitted to the State for distribution back to the proper governmental entity.

The total tax rate per gallon may be as high as 16.7 cents or as low as 9.7 cents depending on the geographic area in which the product was sold.

Reference is made to Exhibit A, a general mailing taxpayer advisory which covers the tax and reporting requirements in greater detail.

2. The scope of motor fuel tax evasion in Florida was extensive during the period commencing in late 1982 and ending in August 1984. Estimates of Florida's tax losses during the 1982-84 period were reported by the media to be in excess of $200 million. This figure included estimates of Federal tax losses as well as the state tax losses of New York and Florida. In no event should Florida's tax loss from the 1982-84 schemes, as perpetrated by the major players involved in organized crime, exceed $10 million.

At this point in time, tax administrators in Florida do not perceive that tax evasion has grown, especially in terms of organized crime involvement from out of state. We have experienced what we perceive to be an increase of tax fraud cases involving local role players. Recently six companies were found by the State Wide Grand Jury to be involved in gasoline tax fraud schemes. Fifteen people connected with these firms were indicted and arrested and jeopardy tax warrants were executed in an effort to secure the state fuel tax liabilities.

Geographically the evasion schemes are confined to the area of largest population in our state. Virtually all of our problems have been located south of a line that could be drawn eastward from Tampa through Orlando and on to Vero Beach. The criminal activity was additionally skewed toward the east coast of our State.

By in large all tax evasion schemes, to be successful, work through a company which is known to enforcement officials as a "bust out" or "burn" company. This company, a duly licensed, permitted or registered company, is a shell through which only paper flows. The "bust out" company will never take possession of fuel and in fact may not have any storage tanks that would permit it to take possession of the fuel. I have attached and marked as Exhibit B, several schematic diagrams of daisy chain operations known to have existed in Florida and perhaps may have existed in other taxing jurisdictions.

The newer forms of tax crimes appear to range from crude imitations of the more sophisticated schemes employed by organized crime to unilateral conversion of taxes collected by a taxpayer who was experiencing difficult economic conditions.

3. Florida's law is for all intents and purposes a new law as it became effective on January 1, 1986. The law was designed to eliminate, to the degree possible, tax fraud schemes of the type that have been publicized in the newspapers and on national television networks.

Key among the provisions of the new law is the section which permits the department to conduct background checks on all license applicants, except for those corporate applicants who are listed on a stock exchange registry. (Exhibit C-Application Form)

A second key to stemming fraud are the reporting requirements of the new law. Detailed schedules of product bought, sold, imported, exported, stored or carried are required to be furnished on a monthly basis. These reports are to include the license numbers of buyers, sellers or warehousers of fuel and will be computer cross matched when programs and resources permit. We are now constructing our cross match inventory system.

Heavy penalties are also part of our new law. Civil administrative fines ranging from $100 for missing information or incomplete returns to 100 percent tax penalties are being imposed against those who are not complying with the provisions of our statute.

Administratively, the department is staffing to reduce the time threshold between receipt of the return and contact with the taxpayer should a return error occur. The targeted threshold time is 10 days but will not to exceed thirty days. Further, audit coverage has increased at the direction of the Executive Director. He has requested that each registrant be audited over the next three year period.

Results are fairly easy to measure. We have denied 6 license applications this year as a result of better investigatory procedures. Return quality has improved as a result of the $100 penalty provision. At least $500 thousand has been assessed against individuals resulting from the individual liability provisions of the statute and audit assessments have increased from 142 totaling $3,829,299 for the first three quarters State FY 1985 to 246 assessments totaling $6.632,363 for the same period State FY 1986. Voluntary remittances have increased also. We have experienced a positive percent change of 5.4 percent for the first 10 months of State FY 1986 over the same period for State FY 1986. ($160.3,1986 v. $152.1,1985-in millions.)

Finally, Florida is heavily committed to a uniform schedule report form which, under the auspices of the National Association of Tax Administrators, is being considered by every state in the Union, including the District of Columbia. When fully implemented by January 1990 this report format will enable states to receive uniform product purchase and sales information via electronic networking. Industry is also heavily involved in this program. At this moment the concept has been adopted by all Central and Southern Region States.

4. Florida has had a long and mutually beneficial relationship with the Internal Revenue Service. The Federal Government has been sharing Income Tax Forms 1040 in support of our Intangible Tax program for over 30 years. In 1972 the Internal Revenue Service began providing us on a routine basis copies of Revenue Agent Reports in support of our Corporate Income Tax Program. In 1980 the department requested that the District and the State enter into an agreement to exchange fuel tax revenue audit changes. There were some confidentiality problems (Sec. 6103, IRC) with the excise tax Revenue Agent Reports that had to be resolved prior to implementation of information sharing. These problems were resolved forthwith and the agencies entered into an implementation agreement involving fuel tax audit changes in 1982. Although referral parameters were quite high in terms of dollar amounts, it is safe to say that more than several returns were shared on an annual basis.

Beginning in 1985 the Service and the department began sharing information on a routine basis. Commencing with the completion of the Federal/State Joint Program on Diesel Fuels, referral parameters were lowered and more information than ever has been exchanged. For example, because of our unique method of assessment, we have sent 129 completed agreed audit changes to the excise tax group since January 1, 1986. These change notices involved 45 business entities, 14 of which were gasoline tax audit changes. On the receipt side, the State has received 13 gasoline audit reports from the excise tax group during the six month period January 1, through June 30, 1986.

Florida and the Internal Revenue Service, Excise Tax Group, has also participated in two joint selection sessions. These scheduled sessions, whether by visitation or by telephone produced some surprises. Each group pre selected their "best" audit targets prior to meeting and at each meeting the lists contained an unusually high percentage of hits. The same name appeared on each list.

The State has geared itself to facilitate the mutual exchange of information by incorporating both the Federal Employees Identification number and the Form 637 Exemption number into the Application for License form. (Exhibit C)

5. Because the point of taxation for State taxation differs from the point of taxation at the Federal level it is not possible for Florida Department of Revenue personnel to estimate the federal revenue loss attributable to untaxed sales in Florida.

6. State revenue personnel are not aware of any specific proposed solutions to the federal excise tax compliance problem. However it would seem reasonable to assume that one proposal would be to relocate the point of taxation to the place of import, in the case of foreign fuel, or to the point

of production of domestic fuel. Should this be the proposal we can speak with some confidence as to the reaction of industry.

Florida's original 1985 draft law taxed fuel on the first import into the State. As previously discussed, the State now taxes fuel on its first sale, which is one step down the distribution chain. The amendment to move the point of taxation was a direct result of industry voicing their concerns over cash flow, increased product costs and extended time periods over which they must wait to make collections of their front end tax expenses. These concerns will also be voiced at the federal level by the middleman suppliers that form the main link in the fuel distribution network.

7. Florida, more than any other state, (except perhaps New York) has been directly involved with the Internal Revenue Service in the matter of fuel taxes since early 1985. Our personnel have had an opportunity to review the federal fuel tax reporting and administrative programs and to talk to high level Service personnel regarding mutual tax evasion problems.

It is our recommendation that the improvements needed to correct the apparent excise tax compliance problems are twofold: improve the report requirements by requiring on IRS Form 720 an accurate accounting of product bought and sold; and by eliminating the exempt purchase privilege allowed by qualifying as a producer on Form 637, Section "J".

Improvement of the report requirements would allow the Service to desk audit returns using vendor/vendee returns as source documents. Detailed inventory and transactional information, like that which is now required by every state in the nation, should also be required by the Internal Revenue Service on their Form 720. State returns detailing similar transactions would then become a more important source document to the examining agent. This legislation in itself would be a big step in preventing mid-level wholesaler tax fraud.

By removing the ability to sell tax free along the distribution chain, ie: revocation of the producers exemption, the Federal Government would create two beneficial results. First, tax monies would flow into the Treasury at an accelerated rate (at the time of import or production rather than at the point of retail sale) and there would be a fewer number of taxpayers to audit for compliance. The Service could, if allowed to maintain their present excise tax resource level, audit a much larger volume of remitted taxes than it is now able to accomplish.

Florida's tax audit personnel are considered to be expert in the field of detection and elimination of tax fraud of the type that has been rampant in the gasoline distribution system. Florida, through people like myself, has been involved in working with other state governments and with the Internal Revenue Service in an effort to upgrade collection systems and personnel in an effort to eradicate tax crimes of this nature. Mr. Miller, my Executive Director, has pledged his 100% support of improvements to the Federal excise tax collection system and is offering to this Subcommittee and to the Service our department's cooperation to the highest degree.

Mr. Chairman, this concludes the prepared testimony. If there are any questions you or the committee members wish to ask, I would be pleased to respond to them at this time.

Thank you.

STATE OF FLORIDA
DEPARTMENT OF REVENUE
TALLAHASSEE, FLORIDA [illegible]

RANDY MILLER
Executive Director

IMPORTANT NOTICE TO ALL MOTOR FUEL DISTRIBUTORS

The 1985 Florida Legislature enacted Chapter 85-342, Laws of Florida, which amended Part I, Chapter 206 and Part II, Chapter 212, Florida Statutes relating to the administration of Motor Fuel Tax. Effective January 1, 1986, all Motor Fuel Distributor's licenses issued by the Florida Department of Revenue will no longer be valid. Entities engaging in the distribution of Motor Fuel will be required to obtain a Motor Fuel license for 1986 which will be renewed on an annual basis.

Who Is Required To Be Licensed?

As of January 1, 1986, all entities who engaged in business as refiners, importers, wholesalers, jobbers, carriers, or terminal facilities of motor fuel must hold a valid Motor Fuel license issued by the Florida Department of Revenue.

Those entities holding a current Motor Fuel Distributor's license as of December 31, 1985 will not have to re-qualify and upon payment of the $30 annual license tax will be issued a wholesaler or importer license. (See Form DR-156A enclosed)

A Wholesaler or Importer license will be issued based on the business location of the company. "Business Location" is defined as a actual office or facility location, an employee or agent representing the company, or the ownership or leasing of storage facility in Florida.

The following definitions apply to the six categories for a Motor Fuel license as established and defined by the 1985 Legislature. To qualify as a refiner, jobber, carrier or a terminal facility, a Motor Fuel License Application (DR-156) must be completed. Please contact the Application Acceptance Section to obtain the correct form and further information.

> "Refiner" means any person who owns and operates one or more refineries and who maintains storage facilities in this state or imports fuel into this state. A refiner also includes any wholly owned subsidiary of such person.

> "Importer" means any person with no business location in this state who holds a valid importer of motor fuel license.
>
> "Wholesaler" means any person who holds a valid wholesaler of motor fuel license issued by the Department and has a business location in this state.
>
> "Jobber" means any person who holds a valid jobber of motor fuel license. A jobber's license grants the privilege of storing and transporting tax-paid fuel in this state and making sales to persons other than the ultimate consumer as well as the ultimate consumer.
>
> "Carrier" means every railroad company, pipeline company, water transportation company, common carrier, and any other person transporting motor fuel, casinghead gasoline, natural gasoline, naphtha, or distillate for others, either in interstate or intrastate commerce, to points within Florida, or from a point in Florida to a point outside of the state.
>
> "Terminal Facility" means any waterfront or offshore appurtenance including a pipeline on land used for the purpose of storing, handling, or transferring both tax-paid and tax-free petroleum products.

Upon receipt of a properly completed application (DR-156A or DR-156) and the $30 license tax, a 1986 Motor Fuel license will be issued allowing a person to transact business in this state. This license must be issued prior to January 1, 1986.

Tax Return Filing Requirements

All individuals holding a valid Motor Fuel license are responsible for filing a monthly report with the Department of Revenue. All reports (DR-119) are due on or before the 20th of the succeeding month. Failure to remit the report and/or monies due the state will result in the imposition of penalty and/or interest and can result in the revocation of the license under the authority granted under 206.[illegible], Florida Statutes.

Refiners, Importers, Wholesalers, or Jobbers who sell to the ultimate consumer such as farmers, construction contractors or other businesses, must collect the local option and voted gas tax for the appropriate county.

Bond Requirement

Each refiner, importer, or wholesaler, except a municipality, county, school board, state agency, federal agency, or special district, must file a bond with the Department.

This bond shall cover three times the average monthly gas tax liability paid or due the department during the preceding twelve (12) calendar months, not to exceed $100,000. The bond must be executed on forms supplied by the Department and guaranteed by a surety company licensed to do business within the state of Florida.

Levy Of Tax On The First Sale

The levy of the tax is presently at the rate of 9.7 cents per gallon (excluding any local option or voted gas taxes). Motor fuel taxes are exempt only on the first sale or transfer of motor fuel within this state by licensed refiners, importers.

Sales by a refiner to another refiner within the state are tax exempt and shall not be considered as the first sale.

The sale of motor fuel for export from the state by a refiner or importer is exempt from fuel taxes when exempted by the Constitution of the United States or the State of Florida. The sale of motor fuel for export from the state is exempt as the first sale only when both the seller and the exporter of the motor fuel have a valid motor fuel license as a refiner or importer.

The sale of motor fuel for export from this state by a wholesaler or jobber is exempt from fuel taxes when exempted by the Constitution of the United States or the State of Florida. The sale of motor fuel by a wholesaler or jobber for export from the state is exempted on the first sale only when the purchaser of the motor fuel is licensed as a refiner or importer.

A wholesaler, refiner, or importer may export motor fuel to his own location tax exempt if the licensee maintains complete and adequate shipping documentation that the motor fuel was removed from the state. Adequate shipping documentation shall include bills of lading and delivery tickets provided by the seller, or a common carrier hauling the fuel, or complete shipping logs provided by the purchaser along with receiving records from the location outside of the state.

Please complete the enclosed application and remit with your $30 license tax to:

Florida Department of Revenue
Carlton Building
Tallahassee, Florida 32301

If you have any questions concerning your registration, please contact Application Acceptance Section at (904) 488-8750.

EXHIBIT A

A. Introduction

Investigative techniques designed to detect acts of fraud, theft, or irregularities have long been a part of the audit procedures employed by public, private, and governmental auditors. For the tax auditor, the procedures are an expansion of scope and detail of normal audit procedures, with an enhanced consciousness of indicators common to operations involved in tax theft and evasion.

In recent years both the Federal Excise Tax rates on Motor and Special Fuel and the tax rates of many States including Florida have dramatically increased. These tax increases have encouraged the development of organizations designed to steal tax revenues and have tempted some honest businessmen to attempt the theft of taxes.

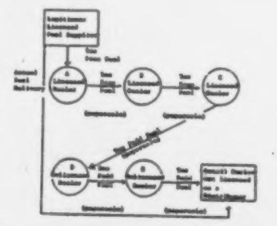
The purpose of this chapter is to introduce the auditor to Motor Fuel/Special Fuel Tax theft scams, to build an awareness of the signs that point toward the theft of taxes, and to help prepare the auditor to conduct a thorough, well-documented audit of businesses suspected of tax theft.

B. The Scene

The following information is presented to depict typical tax theft scams. This presentation will present common circumstances occurring in the operation of organizations designed to steal and to conceal the theft of the fuel taxes. Each method presented can have many variations:

(Variations on Following Pages)

1. Simple Daisy Chain

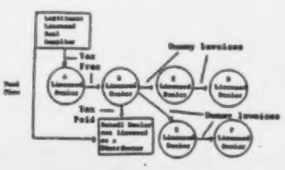


Legitimate Licensed Fuel Supplier
Tax Free Fuel
Actual Fuel Delivery
A Licensed Dealer
B Licensed Dealer
C Licensed Dealer
Tax Paid Fuel
D Unlicensed Dealer
E Unlicensed Dealer
Retail Dealer not Licensed or a Retailer/Jobber

Company A, established to steal fuel taxes, applies for and obtains a License to purchase fuel tax exempt. Companies B, C, D, and E are all related to or owned by Company A. Each was either purchased or established to add to the "Daisy Chain", contribute to the confusion, and aid in the concealment of tax theft.

Company A purchases fuel from a legitimate licensed supplier. Company A then sells the fuel tax free to Company B, who sells the fuel tax free to Company C. Company C sells the fuel to Company D and supplies Company D with a tax paid invoice, but reports no tax on their return filed. Company D gives an invoice to Company E showing all taxes paid. Company E then sells the fuel to an unlicensed retailer or jobber tax paid. The retailer or jobber either picks up or receives delivery of the fuel direct from the legitimate supplier. The timing of the transactions allows Company C to reflect a build up of inventory rather than taxed sales to Company D. This particular scam has a short life and begins to fall apart in 3 to 4 months.

2. Modified Simple Daisy Chain



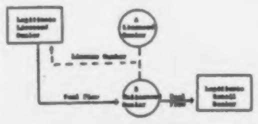
Legitimate Licensed Fuel Supplier
Tax Free
Dummy Invoices
Fuel Flow
A Licensed Dealer
B Licensed Dealer
C Licensed Dealer
D Licensed Dealer
Tax Paid
Retail Dealer not Licensed or a Distributor
E Licensed Dealer
F Licensed Dealer
Dummy Invoices

Company A was established to steal fuel taxes from the State of Florida as well as Federal Taxes. Company A establishes or acquires Companys B, C, D, E and F to accomplish the theft of taxes by helping to conceal the theft and extend the time period of operation prior to discovery.

Company A purchases fuel from a legitimate supplier tax free by issuing a resale certificate. Company A then sells the fuel tax free to Company B who sells the fuel to retail dealers issuing a tax paid invoice. To avoid paying the taxes collected to the State, "B" then makes fictitious invoices for the same fuel out to either Company C or E, who may or may not transfer the fuel on to the next member of the chain. The fuel was delivered direct to the retail dealer at the direction of either Company A or B. The returns and records reflect sales to C, D, E, and F all licensed dealers.

This method of concealment is called dumping and can cover the theft of tax through the build up of inventories reported by C, D, E and F. For the scam to continue beyond three to six months, additional companies are added while old companies close down and disappear.

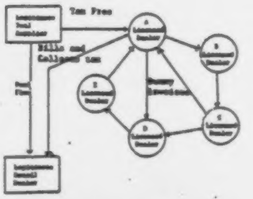
3. The Numbers Game



Legitimate Licensed Dealer
A Licensed Dealer
License Number
Fuel Flow
B Unlicensed Dealer
Fuel Flow
Legitimate Retail Dealer

Company A was established to register as a dealer of fuel and receive a license number to purchase tax exempt (in many cases A is purchased as a going concern who did limited business or operated in a small area). Company B purchases fuel from the legitimate supplier. Company B is able to purchase the fuel tax exempt by using the license number of Company A, who's resale certificate is on file with the supplier. Company B goes to a bank and purchases a cashiers check to pay for the fuel under the name and license number of Company A and pays cash for the fuel. Company B then sells the fuel to legitimate dealers and collects the tax. Company A's returns and records reflect no activity relating to the fuel. Company B, being unlicensed, does not file returns. This method, used reasonably, could go undetected for quite sometime and is therefore very popular.

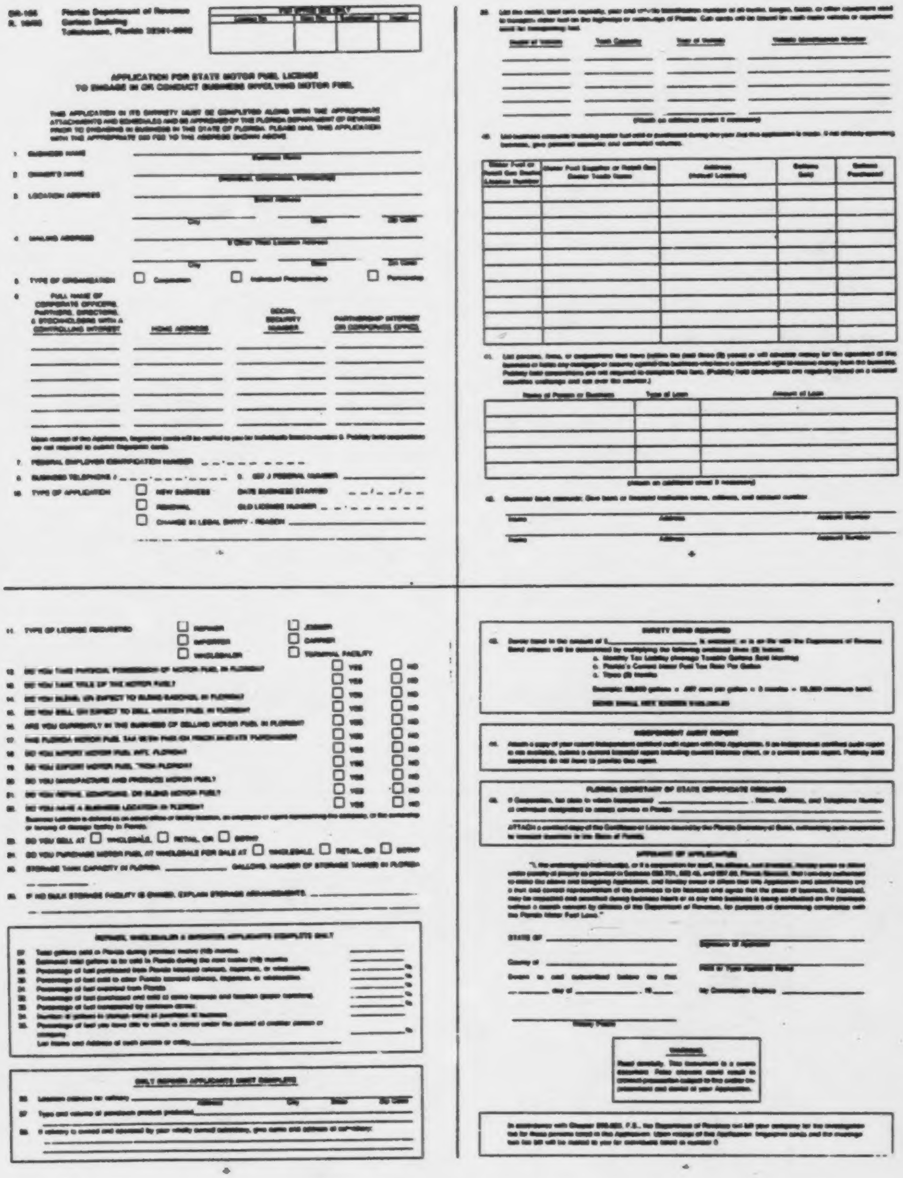
4. Complex Daisy Chain



Tax Free
Legitimate Fuel Supplier
A Licensed Supplier
Bills and Collects tax
Fuel Flow
B Licensed Dealer
E Licensed Dealer
Dummy Invoices
C Licensed Dealer
D Licensed Dealer
Legitimate Retail Dealer

Company A is established to steal Fuel Tax money. The organization in turn purchases or establishes companies B, C, D, and E to aid in the accomplishment of the theft. Company A purchases fuel from a legitimate supplier and directs the supplier to deliver (or a carrier to pick and deliver) the fuel to the legitimate retail dealer. Company A bills the dealer and collects the tax. To conceal the theft of taxes Company A gives a fictitious invoice to B for the fuel, who later invoices Company C for the fuel. Company C then invoices A for the non-existing fuel. Company A purchases additional fuel from the supplier and directs shipment to the true customer. Company A then gives a fictitious invoice to Company D for the total fuel reflected in inventory (including the fuel invoiced from C). Company A also bills the actual customer for the fuel and the tax. Company D then invoices Company E for all the fuel who then invoices Company A. Company A purchases additional fuel from the legitimate supplier and directs the shipment to the legitimate customer. Company A then bills the customer including tax. To cover the theft of taxes "A" invoices "B" who invoices "C" who invoices "D" who invoices "A" for the nonexistent fuel. The ever growing circle of "paper inventory" is created in fashion similar to check kiting; when the inventory flow becomes too large the organization either closes or may utilize dumping as in example 2 to eliminate the inventory and start over.

EXHIBIT B



APPLICATION FOR STATE MOTOR FUEL LICENSE
TO ENGAGE IN OR CONDUCT BUSINESS INVOLVING MOTOR FUEL

EXHIBIT C

Chairman PICKLE. Thank you.

Now we will hear from Leon Rothenberg, executive secretary of the National Association of Tax Administrators.

STATEMENT OF LEON ROTHENBERG, EXECUTIVE SECRETARY, NATIONAL ASSOCIATION OF TAX ADMINISTRATORS

Mr. ROTHENBERG. Thank you, Mr. Chairman.

The National Association of Tax Administrators supports the recommendations and findings of my fellow panelists. That support is reflected in my prepared statement, and in my testimony I will touch on several elements in that statement.

I express the National Association of Tax Administrators' appreciation to the Subcommittee on Oversight for its invitation to present testimony at this hearing on gasoline tax noncompliance.

The National Association of Tax Administrators is an organization of the State revenue agencies of the 50 States and the District of Columbia. NATA serves as a clearinghouse of information on matters relating to all State taxes: Income, sales, and excise taxes. It has as its primary purpose the improvement of State tax administration and, in accordance with this objective, it is devoting a major part of its overall program to the problem of motor fuel tax evasion.

In the statement I have submitted, I note that the States have begun to address the tax compliance problem through the following new programs. These programs in large measure are incipient programs and represent a response and reaction to the evasion problems described in the discussions we have heard this morning.

The programs consist of a new Federal-State cooperative program, an expansion of the State motor fuel tax enforcement efforts, the development of systems for tracking the movement of motor fuel, including the development of a uniform report to facilitate such tracking, and a reexamination of the State motor fuel tax statutes in order to close loopholes which have made evasion possible.

I would like to comment briefly on two of these developments, Federal-State cooperation and first sales laws. The Federal-State Exchange Program under which the Federal Government and the States use each other's tax return information to enforce their taxes, has been operative for more than 60 years.

Until this year, however, the program has been concerned predominantly with income tax return information. This year, in response to increasing evidence of motor fuel tax noncompliance, the IRS and NATA have cooperated in developing three major pilot projects.

One is directed at coordinating Federal and State diesel fuel tax audits, the second at coordinating gasoline tax audits, and the third at training State and Federal auditors and investigators in the special practices designed to discover organized criminal motor fuel tax evasion.

The three projects should contribute importantly to the total effort for effective motor fuel tax enforcement. They are intended to serve as models of programs in which all States will participate.

For the first time, they will combine Federal and State resources and information for motor fuel tax audit purposes, and they will initiate instruction for Federal and State personnel in the specialized training needed in the discovery of organized criminal gasoline tax evasion.

Perhaps of particular interest to the subcommittee, NATA is initiating a State-by-State survey of gasoline tax laws which will show the extent to which tax-free sales are permitted among distributors and other gasoline handlers.

The survey will be designed to provide a basis for the recommendation of a model gasoline tax law. As this panel previously noted, the practice of permitting tax-free sales contradicts the tenets of sound tax administration.

It facilitates the concealment of a taxable product while leaving an unknown number of persons to handle the product without payment of taxes. Like the Federal Government, a great majority of States permit this practice and as has been demonstrated in Florida and New York, it is a practice which could quickly result in a massive amount of tax evasion.

It is a practice which was sanctioned as a convenience to the petroleum distributors by removing taxes from their cash-flow, and it was sanctioned at a time when gasoline tax evasion was viewed as an insignificant problem.

Gasoline tax evasion is now a serious problem, both for the States and legitimate distributors. Since noncompliance enables criminal operators to sell their product at a price substantially below that charged by the honest distributor, the added cash-flow burden would appear to be a small price to pay for the elimination of criminal competition.

In developing a State model gasoline tax law, the first sales feature will be given primary attention. NATA thanks the subcommittee for the opportunity to present testimony.

[The prepared statement follows:]

STATEMENT PRESENTED BY LEON ROTHENBERG, EXECUTIVE SECRETARY, NATIONAL ASSOCIATION OF TAX ADMINISTRATORS TO THE SUBCOMMITTEE ON OVERSIGHT, COMMITTEE ON WAYS AND MEANS, HOUSE OF REPRESENTATIVES HEARING ON GASOLINE TAX NONCOMPLIANCE, JULY 15, 1986

I express the National Association of Tax Administrators' appreciation to the Subcommittee on Oversight for its invitation to present testimony at this hearing on gasoline tax noncompliance.

The National Association of Tax Administrators is an organization of the state revenue agencies of the 50 states and the District of Columbia. NATA serves as a clearinghouse of information on matters relating to all state taxes--income, sales and excise taxes. It has as its primary purpose the improvement of state tax administration and, in accordance with this objective, it is devoting a major part of its overall program to the problem of motor fuel tax evasion.

NATA has been concerned both with identifying the problem and the formulation of programs to curb evasion. There have been important developments in both areas. However, the states have only recently intensified their concern with motor fuel tax noncompliance, and apart from the testimony presented by this panel, state activity in both areas is mainly in a preliminary stage.

NATA welcomes this Subcommittee hearing. It believes that this hearing will provide a strong stimulus to the states to proceed with their plans for addressing fuel tax noncompliance.

THE STATES' INTENSIFIED CONCERN

The principal reason for the states' increased emphasis on motor fuel tax enforcement was expressed to you in the testimony presented by the representatives of California, Florida, and New York. Until recently, gasoline taxation was viewed by the states as an area significantly free of tax evasion problems. The fact that major tax evasion incidents have occurred in three major states has suggested that such tax evasion may exist elsewhere and in fact, be widespread.

There are two principal reasons for this concern:

--One is that the gasoline tax laws of the great majority of the states correspond to those of Florida and New York before they were recently revised--namely, they permit distributors to sell gasoline tax free to one another, thereby creating the opportunity for "daisy chain" tax evasion.

--Secondly, urgent highway needs have compelled sharp increases in state gasoline tax rates on a nationwide basis. They now range up to 19 cents per gallon, so that the maximum combined federal-state gasoline tax rate is now 28 cents per gallon and the maximum combined diesel fuel tax rate is now 35.5 cents per gallon.

It is a long-standing principle in state taxation that where the financial incentive and the opportunity for tax cheating exist, tax evasion occurs. In the motor fuel tax field, both conditions exist nationally.

REASONS FOR PAST LEVELS OF ENFORCEMENT

The states also recognize that in recent years, motor fuel tax enforcement was a generally neglected area. Motor fuel tax enforcement has been at a low level in most states for several reasons.

One is that petroleum distribution has traditionally been regarded as a tightly structured, self-disciplined industry involving only a small number of taxpayers who were often well-known to taxing authorities. The fact that this profile could change quickly without adequate recognition is evidenced in the recent discoveries of "daisy chain" evasion.

A second is that funding for the enforcement of all state taxes has rarely been adequate. As a result, these funds have necessarily been applied, first, to income and sales tax auditing because their revenue productivity has been substantially greater than that of gasoline tax audits.

Because of these several factors, gasoline tax enforcement has often been in an anomalous situation. Conditions have been developing which have made noncompliance increasingly more likely, while gasoline tax laws and their enforcement have remained substantially unchanged.

STATE ACTION

The states have begun to address the motor fuel tax compliance problem through new federal-state cooperative programs, a review and expansion of their motor fuel tax enforcement efforts, the development of systems and uniform reports to facilitate tracking the movement of motor fuel, and a re-examination of their motor fuel tax statutes in order to close loopholes which have made evasion possible. These developments may be described briefly as follows:

FEDERAL-STATE COOPERATION

Previous testimony has been given on the new federal-state cooperative response to the need for increased motor fuel tax enforcement efforts. The Federal-State Exchange Program, under which the federal government and the states use each other's tax return information to enforce their taxes, has been operative for more than 60 years.

Until this year, the program has been concerned predominantly with income tax return information. This year, in response to the increasing evidence of motor fuel tax noncompliance, the Internal Revenue Service and NATA have cooperated in developing three major pilot projects.

One is directed at coordinating federal and state diesel fuel tax audits, the second at coordinating gasoline tax audits, and the third at training state and federal auditors and investigators in the special practices designed to discover criminal motor fuel tax evasion.

The three projects should contribute importantly to the total effort for effective motor fuel tax enforcement. They are intended to serve as models of programs in which all states will participate. For the first time, they will combine federal and state resources and information for motor fuel tax audit purposes, and they will initiate instruction for federal and state personnel in the specialized training urgently needed for the discovery of criminal gasoline tax evasion.

STRENGTHENED MOTOR FUEL TAX ENFORCEMENT

NATA, through surveys conducted by its Committee on Motor Fuel Tax Evasion, has pointed out the need for state appropriations for added motor fuel tax audit and investigative personnel. In a report submitted in October 1985, this committee reported findings which showed that, at that time, the states were employing only 260 full-time and 172 part-time auditors to protect $11 billion in motor fuel tax revenue, and it stressed the need for expanded state efforts.

The need for strengthening staffs devoted to motor fuel tax enforcement has been emphasized at regional tax administrators meetings this year, and NATA plans to survey the states annually on the dimensions of their motor fuel tax enforcement effort. There are indications that, in response to the evasion discoveries and the demonstrated low level of enforcement, states are preparing action to expand their audit and enforcement effort in this area.

ACCOUNTABILITY

The states are also seeking to assemble information on the movement of gasoline to assist in verifying distributor reports. The tracking of motor fuel from its source to the first taxable sale is an important device in the enforcement effort. At the present time, this cannot be done because tracking information is not available.

NATA STATEMENT

To make this tracking possible, the IRS/NATA projects are seeking to obtain information from the U.S. Army Corps of Engineers, the Customs Service, and the Department of Energy which will provide an account of the movement of gasoline before it enters the distribution process.

In addition, NATA has discussed with IRS the possibility of developing a computerized centralized unit which would record all reports relating to the movement of gasoline. The state of New Jersey has taken the lead in this regard, and the subject has been placed on the agenda of an NATA/IRS coordinating committee which meets periodically during the year.

In this same connection, NATA is promoting the use of a uniform distributors report form--a form which would call for essentially the same information in each state. The adoption of such a form by all states would greatly facilitate the recording of information for tracking purposes.

FIRST SALES LAWS

Finally, and perhaps of particular interest to the Subcommittee, NATA is initiating a state-by-state survey of gasoline tax laws which will show the extent to which tax-free sales are permitted among distributors and other gasoline handlers. The survey will be designed to provide a basis for the recommendation of a model gasoline tax law.

As this panel has previously noted, the practice of permitting tax-free sales contradicts the tenets of sound tax administration. It facilitates the concealment of a taxable product by enabling an unknown number of persons to handle the product without payment of tax. Like the federal government, a great majority of states permit this practice and, as has been demonstrated in Florida and New York, it is a practice which can quickly result in a massive amount of tax evasion.

It is a practice which was sanctioned as a convenience to the petroleum distributors by removing taxes from their cash flow, and it was sanctioned at a time when gasoline tax evasion was viewed as an insignificant problem. Gasoline tax evasion is now a serious problem both for the states and legitimate distributors. Since noncompliance enables criminal operators to sell their product at a price substantially below that charged by the honest distributor, the added cash flow burden would appear to be a small price to pay for the elimination of criminal competition.

In the development of model state motor fuel tax legislation, the "first sales" feature will be given primary attention.

Again, NATA thanks the Subcommittee for the opportunity to discuss these matters with you.

Chairman PICKLE. We thank you, Mr. Rothenberg. I note with interest that the NATA is initiating a State-by-State survey of gasoline tax laws which you hope will show the extent to which tax-free sales are permitted among distributors.

I am glad to see you taking that initiative. When you complete the survey, I hope you let our committee have the results. We want to compare that with the IRS survey.

Mr. ROTHENBERG. Well, as my testimony indicated, the State laws, in terms of tax-exempt features, correspond quite closely to the Federal, and in view of everything we have heard today, and what has occurred in recent months, there is a recognition that these laws have to be reexamined.

Chairman PICKLE. I am also pleased to note that you have started a pilot project this year in three different directions, one at coordinating Federal and State diesel fuel audits, in coordinating gasoline audits, and in training Federal and State authorities.

It seems you are trying to emphasize greater coordination at the State and Federal Government level. Most of the hearing has involved discussions about what we can do at the Federal level, and you are saying it ought to be a joint effort, Federal and State.

Mr. ROTHENBERG. Very much so. In reality, the motor fuel tax has been an underfinanced function in terms of enforcement. The combined efforts of the Federal Government will bring new resources and new procedures that will make enforcement more effective.

Chairman PICKLE. Mr. Barger, in Florida, you proposed a first import law, with the tax at the beginning, is that correct?

Mr. BARGER. The initial draft of our revised chapter 206 in 1985 made the imposition of tax at the point of import into the State of Florida.

If you recall in my testimony, I said we can speak with some confidence about the problems that you will hear if you try to impose that same tax point. We suffered through those problems and through the nashing of teeth from industry, and as a consequence, moved back and we still call it a first sale, although the first sale in essence now is tax free from the refiner to the wholesaler.

But it was the wholesaler middlemen who said that it would be a fantastic financial burden upon them to assume the tax at that point.

Mr. SCHULZE. Will the gentleman yield?

Mr. Barger, I wonder if you would take us through that process. Very briefly, tell us the problems that you had and how you solved them?

Mr. BARGER. The proposal for the initial law was that the tax be placed upon the product as it entered the State or was withdrawn from storage at various terminal facilities around the State for sale or movement into Florida.

As you know, Florida does have an international flavor to it, and some of that fuel is consumed in foreign commerce or is actually moved out of the State. That was the proposed point of taxation.

When that bill was introduced, a number of marketers came up to the Department and to the House and the Senate, and gave testimony to the fact that it would increase their financial burden, that they would in fact have to lay out money far in advance of the collection.

It has been discussed here this morning that in fact, there is some credit provisions in the sale of gasoline. Some would have you believe that there is not, but in fact, there is credit provisions in the sale of gasoline.

So they prevailed upon the House and the Senate to define first sale as excluding the first sale to them. They would be happy to collect it, but they didn't want to have to pay it.

There were several other pieces of rationale given, one that it would move the money out of the State of Florida, that it would move the money into the large banking chains in California, New York, and so forth, and that the Florida banks would not have the use of that money.

It was apparently a good argument, because our legislature in their wisdom adopted their argument.

Mr. SCHULZE. What was the result of the collections?

Mr. BARGER. Mr. Schulze, we have had, in spite of the fact that we are taxing, that that first real sale is not taxed, we have experienced a 5.4-percent increase this year over last year, and in terms of actual dollars, Mr. Schulze, it appears to be—just a moment, I have it here—we have collected to date this year $160.3 million for the first 10 months of the State's fiscal year 1986 year versus $152.1 million, so there is about an $8.2 million spread by moving the tax back up the distribution chain closer to the point of importation.

Mr. SCHULZE. Thank you.

Thank you, Mr. Chairman.

Chairman PICKLE. Mr. Barger, let me pursue one more point with you. Our committee has been advised that major oil companies are involved in the evasion of excise taxes on the sale of U.S. Custom-bonded aviation fuel and that they are doing this in Florida. The companies bring in domestic fuel, put it in tanks, and sell it to foreign airlines, but they sell it as imported fuel tax free.

Are you advised of that?

Mr. BARGER. Mr. Chairman the Department is aware that there may be some problems, that there are some problems. The extent of the major or the Seven Sisters participation in that particular problem we are not really aware of. We can't pin it down yet.

Chairman PICKLE. Mr. Barger, is there any monitoring of such sales?

Mr. BARGER. Yes, sir, there is. The Department has entered into an agreement with the Treasury Department. We are obtaining information from the Customs Service, and we are monitoring the sales of the aviation——

Chairman PICKLE. Are you just monitoring that now? Have you just started that?

Mr. BARGER. No, sir. It started, I believe—well, in the recent past, probably 4 to 5 months.

Chairman PICKLE. I would like to have further information about how much monitoring is going on and how long this has been going on. We have just been advised by Florida officials that these major oil companies are actually putting domestic gasoline into bonded storage tanks and they are selling the gasoline to airlines tax free as imported foreign gasoline. That comes from officials in the State of Florida.

If that is going on, your monitoring hasn't caught that?

Mr. **Barger**. I think where we are, Mr. Chairman, and I have been involved in it to a degree—I think where we are is just now to the place where we can put some evidence together to either accept or deny the allegation that the major oil companies are involved.

Chairman **Pickle**. Have you advised the IRS of this possible evasion?

Mr. **Barger**. We have worked with the IRS. The district director is fully aware.

Chairman **Pickle**. The Florida district director knows of this?

Mr. **Barger**. Yes, sir.

Chairman **Pickle**. And he knows of this investigation now?

Mr. **Barger**. Yes, sir.

Chairman **Pickle**. The Washington national office, I would assume, would know it if the Florida office knows it?

Mr. **Barger**. I would assume.

Chairman **Pickle**. How long has this been going on?

Mr. **Barger**. It has been going on perhaps for a year and a half. We have had some aviation fuel problems down there. If you remember, we have had both foreign and domestic aircraft suits brought against us. They have been resolved by the Supreme Court of the United States here in Washington, and probably some of that monkey business started during that period of time.

Chairman **Pickle**. We ask you to submit to us a statement—or the subcommittee will be in touch with you—we want to know the extent of this type of evasion, who is actually doing it, an individual, a distributor, or is it the majors? And we want to know that as quick as we can get the information.

Mr. **Barger**. Your office will get in touch with us?

Chairman **Pickle**. You can be sure of that.

Mr. **Barger**. So the details of the questions that you want the answers to will be given.

[The following was subsequently received:]

STATE OF FLORIDA
DEPARTMENT OF REVENUE
TALLAHASSEE, 32304

RANDY MILLER
EXECUTIVE DIRECTOR

August 20, 1986

The Honorable J. J. Pickle
Chairman
Subcommittee on Oversight
Committee on Ways and Means
U. S. House of Representatives
Washington, D. C. 20515

Dear Mr. Chairman:

This letter is in response to your correspondence of July 22, 1986 wherein you requested that we answer additional questions concerning fuel tax enforcement in Florida. I am pleased to comply with your request.

(1) Enforcement

(A) Has there been effective cooperation between federal and state authorities regarding the problem of gasoline excise tax evasion?

Response:

I believe there is effective cooperation between the Internal Revenue Service and the Florida Department of Revenue.

Item 4, page three of our written testimony before your committee states in part, "Florida has had a long and mutually benefical relationship with the Internal Revenue Service." This statement is true for all taxes administered by my agency, including gasoline excise tax.

Mr. Merline W. Heye, District Director, Internal Revenue Service, Jacksonville and I have met on several occasions to discuss fuel tax issues and our subordinates are in touch with each other on an almost daily basis. We have opened our training program to federal auditors and we have conducted on at least one occasion a joint fuel audit.

(B) Which federal agencies have been most cooperative? Least cooperative?

Response:

We have had experience with only two agencies pursuant to fuel excise tax. Of the two, the Internal Revenue Service has been the most cooperative, while the Customs Service has been the least cooperative.

(C) What, if any, enforcement programs and administrative procedures have been implemented by your state to facilitate the monitoring of gasoline transported in your state?

Response:

We believe we have designed an enforcement program that will allow the state to effectively monitor the transportation of fuel in Florida. Chapter 206 Florida Statutes, as amended by the 1985 Legislature, gave the department many strong tools with which to work. I have, as a matter of policy, elevated fuel tax enforcement programs to a high visibility level within the department. Improvements include:

Legislative

*Administrative fines of $100 for incomplete return information were imposed
*Administrative penalties equal to 100% of the tax may be imposed against officers of corporations for failure to file returns or pay taxes
*Positions were granted to increase the staff of our Returns Processing Section to handle filed returns more promptly and efficiently
*Positions were granted to increase the staff of our Enforcement Bureau to run background and location investigations on prospective applicants
*Persons with felony records can not obtain licenses to deal in fuel products

Policy

*I have directed that every fuel dealer be audited within the next three year period
*We are cooperating with NATA to require uniform reports from all dealers in fuel
*Fuel haulers report requirements are being strictly enforced
*We are constructing an automated fuel tracking system which will track gallons from refiner to wholesaler to retailer
*Tax inspectors stationed at truck weigh stations throughout Florida inspect waybills and invoices for unregistered fuel handlers
*Florida shares fuel import and export information with border and other nearby states.

(2) Registration

(A) In your opinion, how effective is IRS's Form 637 registration system for tax-free sales? Are registration numbers easily obtained and misused?

Response:

My staff has informed me that the present Form 637 registration system for tax free sales of gasoline is not effective. The reasons that the system is ineffective is contained in part "b" of your question. The numbers are easily obtained and they are misused.

If numbers are not granted to the applicant by the District in which the applicant desires to do business, the applicant may apply in another District. The applicant simply rents a Post Office box in the second District to evidence a local business location. The process may be repeated as often as necessary to obtain the number.

Misuse is also prevalent. In one case a number was granted on the premise that sales were going to be made to a federal agency. No sales were made, yet the fuel handler retained his Form 637 registration. No taxes had been remitted to the Federal Government on fuels purchased or sold.

(B) Does your state rely on the IRS registration number of a producer for state gasoline excise tax purposes, or is a separate state registration number issued?

Response:

Florida issues a unique state registration number to dealers in gasoline. In fact, we distinguish by numeric code between licenses issued to the various types of fuel dealers and handlers. License prefix code values are:

Refiner	"01"	Wholesaler	"02"
Importer	"03"	Jobber	"04"
Carrier	"05"	Terminal	"06"

We do capture and maintain as part of our license master file history data the Form 637 registration number assigned by IRS.

(C) Which changes would you recommend in the IRS registration system?

Response:

Assuming the federal tax point on gasoline remains unchanged, we recommend the following changes.

*Background and site investigations of applicants prior to registration
*Restrict issuance of Form 637 registration to the District where principle office of applicant is located
*Establish a national reference file of Form 637 registrants
*Promulgate minimum registration requirements
*Install bonding provisions to cover anticipated unpaid tax revenues.

(3) In your opinion, what could the Federal Government do to improve federal gasoline excise tax collections or compliance with the law? How would these measures help your state combat its gasoline tax evasion problem?

Response:

I believe that the Federal Government could, by insuring that agencies such as Justice, IRS, Customs and the Federal Highway Administration act together in a common purpose, eliminate the intrusion of organized crime in the fuel business. Specifically, the IRS must be given the resources to examine for civil purposes and investigate for criminal violations a broader base of taxpayers in the industry. The Department of Justice must be willing to prosecute complex daisy chain schemes as well as more simple criminal violations of the tax code.

Customs must be given the resources to assure that fuel brought into bond is in fact foreign product rather than domestic fuel that has been relabeled during transit on the high seas. Fuel origin assurance can be achieved by chemical analysis and better investigative techniques. Bonded product should also be submitted to closer end user scrutiny.

The Federal Highway Administration and the Army Corps. of Engineers can be of assistance to federal and state agencies by sharing fuel use and fuel transport reports with the federal and state tax agencies. The information could be used in determining the extent of evasion and under certain conditions may help to identify the evaders.

Certainly, increased enforcement on the federal side of the spectrum will benefit state tax administrators. However, increased enforcement coupled with information sharing, training and expanded knowledge of our individual tax laws will benefit both the Federal and State Governments.

(4) Gasoline Sales Data

(A) How accurate is your state data on gasoline sales?

Response:

Gasoline sales figures are data entered directly from tax returns and schedules. Entry is unverified on original input but each return is balanced after input. I believe our sales figures accurately reflect the tax returns received by the department.

(B) Is your data sufficent to enable you to enforce your gasoline excise tax laws.

Response:

The data required to be supplied with our returns is sufficient to enforce our gasoline excise tax laws.

(C) Do you use any federal gasoline data to detect state gasoline excise tax evasion?

Response:

The department utilizes federal audit change documents as an aid in detecting state gasoline tax evaders.

(E) What additional federal data, if any, is needed?

Response:

Federal Form 720, Excise Tax Return, should be revised to include details of fuels purchased and sold by the taxpayer. In its current format the return requires the taxpayer to enter only the tax due with the return. If no tax is due no return is required. We believe the tax return should contain at a minimum, details of fuels purchased, exempt fuels sold, taxable fuels sold.

(5) What experience is the Florida Department of Revenue having with regard to the sale of foreign and domestic airlines of gasoline from bonded facilities in Southern Florida?

(A) Is there a significant excise tax evasion scheme concerning such sales?

Response:

Because our investigation is not complete, we can only state that the problem may be significant. Our investigators are working under the assumption that the problem is significant and we are devoting considerable resources to the problem.

(B) If so, what is the extent of the scheme?
How is the scheme structured?

(C) Who is participating in the scheme?
Are major oil companies involved?

Response:

As previously mentioned, the scheme, or perhaps more appropriately schemes, appears to be broad based and may involve all members of the distribution chain and perhaps consumers of the fuel. The structures vary as we move down the distribution chain as evidenced by the opening paragraphs to this section.

(D) What proof do you have that the scheme is continuing? How effective is the U. S. Customs Service in monitoring such sales? Should more be done by the Federal Government to combat the scheme?

Response:

Proof of the ongoing tax avoidance schemes is contained in the periodic reports filed by the departments investigators.

From our perspective, the U. S. Customs Service has not been granted sufficient staff resources with which to do their job. Fuels are sold 24 hours a day and they cannot monitor all sales from bond. We believe that the monitoring process could be enhanced given adequate personnel positions and support resources.

The Federal Government could as mentioned, establish more positions and require chemical analysis of fuel products prior to placing the fuel into bond.

Mr. Chairman, I appreciate the opportunity to respond to these follow-up questions. Please do not hesitate to contact me if I can be of further assistance.

Thank you for your cooperation.

Sincerely,

Randy Miller
Executive Director

Chairman PICKLE. Let me ask you, Mr. Chu, how much do you think you have actually saved in New York? You passed a law, it may not be perfect, but how much do you think you have saved on sales this year?

Mr. CHU. Sales tax evasion, of the $123 million we have collected so far, in both, of the $123 million of increase in both motor fuel and sales tax over the first 9 months of last year, $60 million of that is sales tax, State and local.

Chairman PICKLE. Mr. Nunes, we have said that this loss may be a billion dollars a year. We take those figures primarily from what has been happening in New York. I don't know to what extent this type of evasion has been going on in California, but do you think losses are at least that high?

Mr. NUNES. I would say that nationwide they are at least $200 million and probably higher. Based on the information that we have from the gathering of information from the suppliers, we feel that we have got a $30 to $50 million problem. We have probably 10 percent plus of the gasoline sales from the United States, and it is at a 6-percent rate that we are figuring that loss.

Chairman PICKLE. New York says that under this new law which went into effect in June 1985, in the first 9 months of last year $123 million in extra State and local revenues have been collected.

If you could get $123 million from New York, how could you say that the loss nationwide would only be $200 million?

Mr. NUNES. I am talking about our experience at a 6-percent tax rate, which would give us a loss we estimate of between $30 and $50 million. If you take the $50 million figure and consider California has 10 percent, that is $500 million. And at the bottom side, I would think it would be in the neighborhood of $200 million. We don't know whether this is going on in every State, to what extent the problem exists——

Chairman. PICKLE. I don't know what it is in my State, but if New York is saving $123 million, I have to assume that if we had a change in the Federal law, if we could decide on one, the savings on the loss would be tremendous. I think the problem is of such enormous size that we must give immediate attention to it.

I thank you gentlemen. I appreciate your testimony. Now we have your testimony in its entirety and we are studying it and appreciate very much what you have given us on the record. Thank you to all you gentlemen.

Do you have any questions?

Mr. SCHULZE. No, Mr. Chairman. Thank you.

Chairman PICKLE. Thank you all.

[The following was subsequently received:]

J.J. PICKLE, TEXAS, CHAIRMAN
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U.S. HOUSE OF REPRESENTATIVES
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A.L. SINGLETON, MINORITY CHIEF OF STAFF

BETH KUNTZ, SUBCOMMITTEE STAFF DIRECTOR

July 22, 1986

Mr. Roderick G.W. Chu
Commissioner
Department of Taxation and Finance
State of New York
W. Averell Harriman State
  Office Building Campus
Albany, New York 12227

Dear Commissioner Chu:

Enclosed are additional questions the answers to which will provide a more complete record for the hearing on gasoline excise tax evasion that was held by the Subcommittee on Oversight on July 15, 1986.

I hope you will be able to expeditiously respond to the enclosed questions, as the hearing record will be going to the printer on September 12, 1986.

If you have any questions, please contact Beth Kuntz, Staff Director, at 225-5522. Thank you for your cooperation on this matter.

Sincerely,

J. J. Pickle, Chairman
Subcommittee on Oversight

JJP/tmk

Enclosure

QUESTIONS FOR NEW YORK DEPARTMENT OF TAXATION AND FINANCE

1. Enforcement

   A. Has there been effective cooperation between federal and state authorities regarding the problem of gasoline excise tax evasion?

   B. Which federal agencies have been most cooperative? Least cooperative?

   C. What, if any, enforcement programs and administrative procedures have been implemented by your state to facilitate the monitoring of gasoline transported in your state?

2. Registration

   A. In your opinion, how effective is IRS's Form 637 registration system for tax-free sales? Are registration numbers easily obtained and misused?

   B. Does your state rely on the IRS registration number of a producer for state gasoline excise tax purposes, or is a separate state registration number issued?

   C. Which changes would you recommend in the IRS registration system?

3. In your opinion, what could the Federal Government (IRS, Justice, Customs, Federal Highway Administration) do to improve federal gasoline excise tax collections or compliance with the law? Would these measures help your state combat its gasoline excise tax evasion problem?

4. Gasoline Sales Data

   A. How accurate is your state data on gasoline sales?

   B. Is your data sufficient to enable you to enforce your gasoline excise tax laws?

   C. Does the Federal Government use your data for enforcement of its gasoline excise tax laws?

   D. Do you use any federal gasoline data to detect state gasoline excise tax evasion?

   E. What additional federal data, if any, is needed?

RESPONSE FROM THE NEW YORK STATE DEPARTMENT OF TAXATION AND FINANCE TO QUESTIONS ON GASOLINE TAX EVASION

August 1986

Enforcement

Question 1A: Has there been effective cooperation between federal and state authorities regarding the problem of gasoline excise tax evasion?

Answer: We have been extremely fortunate in New York State that in November 1982, the Long Island Organized Crime Task Force was formed. Made up of representatives of the FBI, the IRS, the U.S. Attorney for the Eastern District, the Organized Crime Strike Force for the Eastern District, the New York State Attorney General, the Police Departments and District Attorneys of Nassau and Suffolk Counties and the New York State Department of Taxation and Finance, this cooperative enforcement group has proven very effective and valuable. This Task Force was prompted by contact at the investigator level and was a fortuitous development rather than the result of a high-level policy decision.

In December 1985, the New York Tax Department began developing a joint excise tax audit program with the IRS. Audits are currently in progress. To date, the cooperation between the two agencies has been highly effective and initial results of the audits appear very promising.

Question 1B: Which federal agencies have been most cooperative?

Answer: Our experience with all federal agencies, vis-a-vis, cooperation has been satisfactory. If we were to choose one that has been most cooperative, it would be the Internal Revenue Service, our federal counterpart as a revenue collection agency. Our contacts with the Army Corps of Engineers which tracks barge traffic have been the most problematical.

Our Enforcement Division has developed good working relationships with the Coast Guard, the FBI, the IRS, U.S. Postal Inspectors and the Immigration and Naturalization Service.

Question 1C:

What, if any, enforcement programs and administrative procedures have been implemented by your state to facilitate the monitoring of gasoline transported in your state?

Answer:

Enforcement programs and administrative procedures implemented by New York to facilitate the monitoring of gasoline in New York include:

1. Monthly, and in some cases semimonthly, visits to selected terminals to gather information regarding import activity. This procedure allows us to identify importation by nonregistered distributors and provides a basis for comparison with imports ultimately shown on selected distributors' tax returns.

2. Quarterly observation of physical inventories of storage terminals.

   This activity serves many purposes. First, it provides a basis for assuring that inventory balances shown on monthly tax returns are reasonably stated. It gives our audit and enforcement staffs a thorough understanding of the operations of storage terminals in general, as well as firsthand knowledge of how particular terminals operate; what their storage capacities are; which firms (suppliers, transporters and customers) they deal with regularly, etc. This activity also alerts us to changes in the petroleum industry in general and the industry's operation in New York State in particular. And finally through our regular physical presence out in the field, it is believed that this activity serves as a deterrent to noncompliance in filing tax returns and paying the proper amount of tax.

3. The requirement for monthly reports to be filed by storage operators and importing transporters of motor fuel. These reports serve as third party verification of information reported by

registered distributors on their tax returns. More recently, legislation has been passed which requires the licensing of terminal operators and importing transporters. As a result of such legislation, which includes sanctions against these entities should they be determined to be involved in aiding and abetting the illegal importation of motor fuel into New York State, we believe all parties involved in the distribution of gasoline in the State have a vested interest in the proper reporting of such distribution and the resulting proper payment of all the applicable state taxes.

Registration

Question 2A: In your opinion, how effective is IRS's Form 637 registration system for tax-free sales? Are registration numbers easily obtained and misused?

Answer: Although our staff does not use the federal registration system for any of our purposes and thus has little contact with it, it is still their opinion that the Federal Form 637 registration system is ineffective. It also appears that federal registration numbers are in most cases easily obtained and in many cases they are abused.

Question 2B: Does your state rely on the IRS registration number of a producer for state gasoline excise tax purposes, or is a separate state registration number issued?

Answer: New York State has a separate registration system.

Question 2C: Which changes would you recommend in the IRS registration system?

Answer: They should first administer, or at the very least, control and monitor, the administration of their registration system, on a centralized, national level. Secondly, there should be a thorough background review of the applicant's financial status, tax compliance history and familiarity with the petroleum distribution industry. Finally, adequate bonding should be required to protect federal revenues.

Question 3: In your opinion, what could the Federal Government (IRS, Justice, Customs, Federal Highway Administration) do to improve federal gasoline excise tax collections or compliance with the law? Would these measures help your state combat its gasoline excise tax evasion problem?

Answer: See Commissioner Chu's testimony presented to the Subcommittee on July 15, 1986.

Question 4A: How accurate is your state data on gasoline sales?

Answer: We believe that the gasoline sales data that we have, at least since the beginning of the petroleum importation law on June 1, 1985, is accurate. We do not, however, have an independent source to confirm the petroleum gallonage reported to us on state tax returns. Also, there is insufficient reliable data on retail gasoline sales. Therefore, we are less able to quantify changes in consumption.

Question 4B: Is your data sufficient to enable you to enforce your gasoline excise tax laws?

Answer: We believe the data is sufficient to enforce our gasoline excise tax laws to the extent that we are able to spot suspicious changes in our tax data. For instance, a sharp fall off of taxable sales and decreases in revenue may indicate a compliance problem.

Question 4C: Does the Federal Government use your data for enforcement of its gasoline excise tax laws?

Answer: We are not sure of the extent to which our data is used by the Federal Government to enforce its excise tax laws. We have found that during the conduct of our joint gasoline audits, the federal auditors use the state tax return information in their audit procedures.

Question 4D: Do you use any federal gasoline data to detect state gasoline excise tax evasion?

Answer: Generally, we do not use any federal gasoline data to detect gasoline excise tax evasion. We have found that federal data is subject to the same problem that we experienced with our data previously to the enactment of the petroleum importation law. That is, noncompliance will make sales or consumption data unreliable.

Question 4E: What additional federal data, if any, is needed?

Answer: We believe the Army Corps of Engineers and the Coast Guard have data which would be very useful in monitoring the importation of gasoline into New York State if it were available. In addition, as previously stated, we encourage the development of a joint federal/state motor fuel tracking system. Such a system would enable us to quantify motor fuel shipment patterns.

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Ways and Means
Subcommittee on Oversight

STATE OF NEW YORK
DEPARTMENT OF TAXATION AND FINANCE
W. AVERELL HARRIMAN STATE OFFICE BUILDING CAMPUS
ALBANY, NY 12227

RODERICK G. W. CHU
COMMISSIONER OF TAXATION AND FINANCE
PRESIDENT, STATE TAX COMMISSION

September 15, 1986

The Honorable J. J. Pickle, Chairman
Subcommittee on Oversight
Committee on Ways and Means
Cannon House Office Building
Washington, D.C. 20515

Dear Chairman Pickle:

Once again, I would like to thank you for inviting me to testify before your Subcommittee looking into federal gasoline excise tax evasion.

At the hearing there was a great deal of difference in the various estimates of how much revenue the federal government is losing to gasoline tax evaders. I couldn't reveal it at the time, but we had an investigation underway which could shed some light on this question. Since the principals in the investigation were indicted July 23 on State charges, I can now give you some details of the investigation.

As you can see from the enclosed press release from the Attorney General's office and from my statement, a small group of individuals in only one six-month period in 1984 managed to steal $5.5 million in federal excise taxes and an additional $11 million in State taxes. The fact that so much could be stolen so quickly by so few indicates the possible proportion of the national problem.

I have enclosed some newspaper clips on the indictments. I trust this information will be of assistance to you, and if you need further information please have your staff contact my Public Information Director, Karl Felsen at (518)457-4242.

Sincerely,

Roderick G. W. Chu
Commissioner

Enclosures

NEW YORK STATE DEPARTMENT OF TAXATION AND FINANCE

NEWS

Roderick G. W. Chu
Commissioner of
Taxation and Finance

W. Averell Harriman State Office Building Campus
Albany, NY 12227

Office of Public Relations
(518) 457-4242 (212) 488-4767

STATEMENT BY RODERICK G. W. CHU

PRESS CONFERENCE WITH ATTORNEY GENERAL ROBERT ABRAMS

JULY 23, 1986

The past few weeks have been some of the most important and eventful weeks in the long war against gasoline tax evasion. On June 29 and July 2, with the help of Attorney General Abrams staff and with intelligence supplied by the Long Island Organized Crime Strike Force, we seized 1.3 million gallons of suspected contraband gasoline imported by Score Oil Corporation. On July 14, Governor Cuomo signed into law our First Import Enforcement Enhancement Bill. Just as the original First Import Law, which went effect June 1 of last year, gave us a powerful weapon in combatting the daisy chain scheme, this new law gives us the means to fight the new "buy-out/bust-out" scheme which bootleggers have begun to use. And now, today, after a long, difficult investigation, comes this extremely important indictment.

We are winning the war against the bootleggers. During the first nine months of the First Import Law, State revenues shot up $123 million. Our success has been so significant that in a House Ways and Means Hearing this past week, Treasury and IRS officials cited the New York law and the cooperative enforcement efforts as a model that the federal government should follow in tackling what is now a national excise tax evasion problem.

But, no one should be lulled into a sense of complacency. Without the continuing work of the Strike Force, without the continued grueling work on the part of the Attorney General's prosecutors, without the continued vigilance and aggressiveness on the part of my investigators, and without the continued help from the honest elements of the petroleum industry, we will find ourselves back in the situation of a few years ago when we were losing hundreds of millions of dollars to gasoline tax evaders.

My congratulations to all those who took part in the investigation that has been revealed today.

Albany
TIMES UNION
Thursday, July 24, 1986
Page B-16

Bootleg gasoline scam busted with arrest of 7

Staff and wire reports

HAUPPAUGE — A bootleg gasoline scam on Long Island cheated the state and federal governments out of $16.5 million in taxes before it was broken up with the arrest of seven people Wednesday, authorities said.

State Attorney General Robert Abrams said it is the largest gasoline bootlegging operation ever prosecuted in the United States.

CHU

Sources close to the investigation say two of the men, Brooklyn residents Igor Porotsky and Igor Roizman, are believed to be "hidden partners" in Jolanna Enterprises of Hudson and allegedly are tied to an emerging organized crime group composed primarily of immigrants from Soviet bloc countries.

This week's arrests are similar to a case now pending in Albany County Court involving two more Brooklyn men, David Bogatin and Michael Markovitz, who were indicted for allegedly evading approximately $1.5 million in state and local taxes on gasoline.

Abrams, other state officials, federal tax agents and local prosecutors announced the most recent arrests Wednesday and promised more.

"We are winning the war against gasoline bootlegging," state Tax Commissioner Roderick G.W. Chu said. Harvey Borak, chief of criminal investigations for the Internal Revenue Service in New York, said, "This is only the beginning. There's going to be more to come."

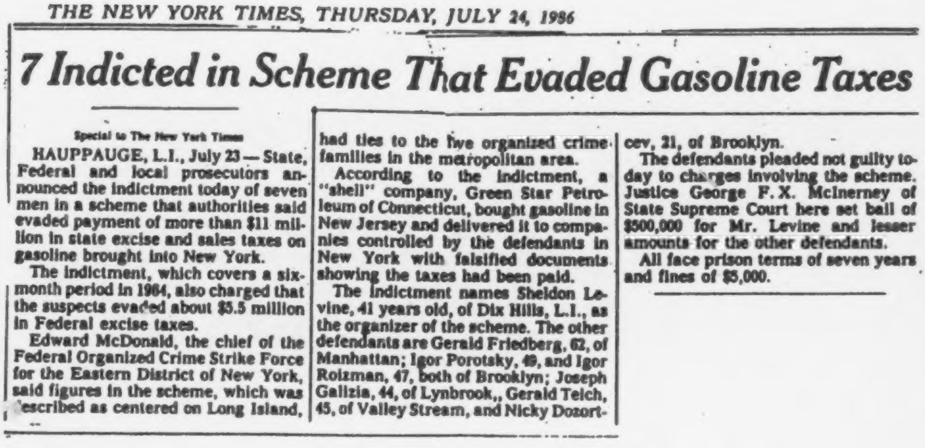
Abrams said the defendants conspired to bring the gasoline into New York from New Jersey through a "phantom" company called Green Star Petroleum Inc., which then issued false documents that made it look as if state and federal taxes had been paid.

Suffolk County District Attorney Patrick Henry said the gasoline was generally sold to the public at "those scrubby little stations where you don't recognize the names."

He said it was "the first significant case in the country involving stealing of state and federal excise taxes on gasoline."

James Yelvington, special agent in charge of the FBI's New York Criminal Division, said information about the arrests was being distributed to other FBI offices nationwide where similar prosecutions would be possible.

Chu said the higher-than-average taxes on gasoline in New York state made it obvious as a site for the first major crackdown on gasoline bootlegging.



THE NEW YORK TIMES, THURSDAY, JULY 24, 1986

7 Indicted in Scheme That Evaded Gasoline Taxes

Special to The New York Times

HAUPPAUGE, L.I., July 23 — State, Federal and local prosecutors announced the indictment today of seven men in a scheme that authorities said evaded payment of more than $11 million in state excise and sales taxes on gasoline brought into New York.

The indictment, which covers a six-month period in 1984, also charged that the suspects evaded about $5.5 million in Federal excise taxes.

Edward McDonald, the chief of the Federal Organized Crime Strike Force for the Eastern District of New York, said figures in the scheme, which was described as centered on Long Island, had ties to the five organized crime families in the metropolitan area.

According to the indictment, a "shell" company, Green Star Petroleum of Connecticut, bought gasoline in New Jersey and delivered it to companies controlled by the defendants in New York with falsified documents showing the taxes had been paid.

The indictment names Sheldon Levine, 41 years old, of Dix Hills, L.I., as the organizer of the scheme. The other defendants are Gerald Friedberg, 62, of Manhattan; Igor Porotsky, 49, and Igor Roizman, 47, both of Brooklyn; Joseph Galizia, 44, of Lynbrook,, Gerald Teich, 45, of Valley Stream, and Nicky Dozortcev, 21, of Brooklyn.

The defendants pleaded not guilty today to charges involving the scheme. Justice George F. X. McInerney of State Supreme Court here set bail of $500,000 for Mr. Levine and lesser amounts for the other defendants.

All face prison terms of seven years and fines of $5,000.

DAILY NEWS

Thursday, July 24, 1986

Ex-Sovs held in mob gas scam

By EDWARD KIRKMAN
and MIKE SANTANGELO

Daily News Staff Writers

Three alleged members of the Russian immigrant underworld and a man identified as an enforcer from the Genovese crime family were arrested yesterday as part of a seven-man gang charged with bilking the government of $16.5 million in gasoline taxes.

State Attorney General Robert Abrams said the gang failed to pay $11 million in state and $5.5 million in federal taxes on gas imported from New Jersey between June and December 1984 and used the Mafia enforcer to "smooth over" any snags.

Abrams said the case is the largest gas-bootlegging operation ever prosecuted in the U.S.

No-name gas stations

The link between Russian gangs and "an old-line organized crime family" is the first uncovered by law enforcement officials, according to one of the investigators in the bootlegging case.

According to a 186-count state indictment, Sheldon Levine, 41, of Dix Hills, L.I., alleged mastermind of the gang, forged documents showing he had paid taxes on gas he imported to Long Island from New Jersey. With the help of reputed mob enforcer Joseph (Joe Glitz) Galizia, 44, of Lynbrook, L.I., an alleged soldier in the Genovese family, he recruited three Russian immigrants and two others to distribute the untaxed gas through a string of no-name gas stations.

Also charged with tax evasion and theft are: Gerald Friedberg, 62, of Manhattan; Gerald Teich, 45, of North Valley Stream, L.I., and Russian immigrants Nicky Dzortcev, 21, of Manhattan, and Igor Porotsky, 49, and Igor Roizman, both of Brooklyn.

All face up to seven years in prison.

Probe took a year

A source close to the investigation said the indictments are the result of a yearlong investigation of the growing involvement of an emerging Russian mob in the gas distribution industry. Officials said the investigation is continuing and more indictments are imminent.

The seven pleaded not guilty when arraigned in Suffolk County Supreme Court and were released until a hearing Aug. 1. Bail was set at $500,000 for Levine, $150,000 for Galizia, Porotsky and Roizman, $100,000 for Teich, and $50,000 for Dzortcev.

Try, try again

Advocates for the homeless went into two courts yesterday trying to revive their referendum seeking to guarantee shelter for homeless families with children.

City Clerk Carlos Cuevas last week invalidated 29,000 of the 54,000 signatures on petitions for the referendum, leaving the advocates nearly 5,000 short.

Lawyers for the Committee for New York's Future, working with the Coalition for the Homeless, filed papers in Manhattan Federal and Supreme courts charging that the clerk improperly handled the petition.

They said Cuevas shipped the petition to a Suffolk County firm that entered the names into a computer. This allegedly led to a 40% error rate, disqualifying thousands of valid signatures.

Hearings were scheduled in both courts for Monday.

News from
Attorney General
Robert Abrams

Department of Law
Two World Trade Center
New York, NY 10047

Department of Law
The State Capitol
Albany, NY 12224

For Further Information Contact
Timothy Gilles
212/488-3334—518/474-7330

FOR RELEASE: WEDNESDAY, JULY 23, 1986
AFTER 10:30 A.M.

INDICTMENTS RETURNED IN ALLEGED GASOLINE BOOTLEGGING SCHEME

State and Federal prosecutors announced today (Wednesday) the indictments of seven New York residents on charges of operating a sophisticated interstate scheme to evade the payment of over $11 million in excise and sales taxes on gasoline imported into New York State.

The case involves the largest alleged gasoline bootlegging operation ever prosecuted in the United States. In addition to the State taxes which were the subject of the indictment, approximately $5.5 million in Federal excise taxes were allegedly evaded, bringing the total to $16.5 million evaded over a six-month period in 1984.

The indictments were announced this morning by State Attorney General Robert Abrams, whose office presented the case to a grand jury in Suffolk County; Suffolk County District Attorney Patrick Henry; Nassau D.A. Denis Dillon; State Tax Commissioner Roderick G.W. Chu; Edward McDonald, Chief of the Organized Crime Strike Force for the Eastern District of New York; James Yelvington, Special Agent-in-Charge of the FBI's New York Criminal Division; and Harvey Borak, Chief of Criminal Investigations for the Internal Revenue Service in New York. These agencies are members of the Long Island Oil Industry Organized Crime Task Force.

The scheme involved the creation of an alleged "shell" corporation, Green Star Petroleum, which obtained a gasoline distributor's license from the State of Connecticut and which imported gasoline into New York from New Jersey. Green Star purportedly paid to New York State excise and sales taxes on the gasoline it imported and then sold the gasoline to other corporations controlled by the defendants with the taxes supposedly having already been paid. In fact, according to the indictment, the tax money was never paid over to the State but was appropriated by the defendants.

(more)

Named as the principal organizer of the scheme was Sheldon Levine, 41, of 10 Essington Lane in Dix Hills, the president and owner of No Brand Petroleum, Inc., and Snug Harbor Fuel Corp., both located in Melville, N.Y. Throughout much of 1984 and 1985, Mr. Levine was the largest single distributor of unbranded gasoline on Long Island, with annual revenues estimated at $100 million. He was indicted on 174 felony and 12 misdemeanor counts including two counts of grand larceny, 172 counts of falsifying business records, one count of criminal solicitation, one count of conspiracy, and 10 counts of violating the tax law.

The other defendants, who were also indicted on multiple counts, are Gerald Friedberg, Igor Porotsky, Igor Roizman, Nicky Dozortcev, Joseph Galizia and Gerald Teich. (See attached list.)

If convicted, the defendants each face up to seven years in prison and fines of $5,000 or double their illegal gain.

The indictment alleges the existence of the "Green Star Conspiracy" among the seven defendants and others not named in the indictment, using Green Star Petroleum Inc. and several other corporations. According to the indictment, Green Star imported 70 million gallons of gasoline between July and December, 1984, mostly by barge from New Jersey, and sold that gasoline to distributors and wholesalers controlled by the defendants. Documents were allegedly created which represented that Green Star had paid all excise and sales taxes due to the State of New York, which, if true, would mean that subsequent purchasers of the gasoline would not owe any taxes to the State but rather would reimburse Green Star for the taxes it had supposedly already paid. However, the indictment charges, Green Star paid no taxes to the State, resulting in the evasion of $6 million in sales taxes and $5 million in excise taxes during the six-month period.

The indictment charges that the scheme was decided upon during a meeting in July, 1984, among Sheldon Levine, Igor Porotsky and Igor Roizman and that these three and the other conspirators "divided and shared" the taxes which were collected but not paid to the State.

According to the indictment, Green Star Petroleum, which was incorporated February, 1984, was nominally headed by Stanislowa Korsakowska, a citizen of Poland whose only previous experience in the gasoline industry had been as a service station attendant. In November, 1984, Ms. Korsakowska was allegedly paid $10,000 to return to Poland.

The indictment alleges that the defendants attempted to conceal their tax evasion by creating false sales invoices for Green Star showing that the taxes had been paid and by filing false motor fuel tax returns and other reports with the States of New Jersey and Connecticut. They are also charged with failing to file required New York State sales and excise tax returns.

According to prosecutors, the "Green Star Conspiracy" ceased using Green Star Petroleum, Inc., as its importer after that firm's license was cancelled by Connecticut in December, 1984. The investigation of the conspiracy's activities after that date is continuing.

An additional count against Sheldon Levine, Joseph Galizia and Gerald Teich charges them with criminal solicitation for allegedly attempting to persuade defendant Gerald Friedberg to destroy records which had been subpoenaed by the Attorney General for the grand jury conducting the investigation.

During the course of the investigation, an eavesdropping warrant was obtained by the Attorney General, and eavesdropping devices were installed in Levine's business offices at 445 Broadhollow Road in Melville. Video cameras to monitor the building were also installed.

On February 13, 1986, twelve search warrants were executed by 70 law enforcement agents. (See attached list for locations.)

The Long Island Oil Industry Organized Crime Task Force includes prosecutors and investigators from the Office of the New York State Attorney General; Nassau and Suffolk District Attorney's offices; the Office of the U.S. Attorney, Eastern District of New York, and the Organized Crime Strike Force, Eastern District of New York; the New York State Department of Taxation and Finance, Nassau and Suffolk County Police Departments, the Federal Bureau of Investigation, the Internal Revenue Service, the New Jersey Attorney General's Office and the Department of Revenue Services of the State of New Jersey.

The grand jury presentation was handled by Assistant Attorney General Vincent O'Reilly along with Assistant District Attorneys Raymond J. Jermyn from Suffolk and Kitley Covill of Nassau, who were designated as Special Assistant Attorneys General for purposes of the investigation. The matter is being supervised by John M. Ryan, Chief of the Attorney General's Criminal Prosecutions Bureau.

LIST OF DEFENDANTS AND CHARGES

DEFENDANT	AGE	ADDRESS	AFFILIATION	CHARGES
Sheldon Levine a/k/a Shelly Levine	41	10 Essington Lane Dix Hills, N.Y.	Owner and president, No Brand Petroleum, Inc. and Snug Harbor Fuel Corp.	2 counts, Grand Larceny in the Second Degree (Class D felony), 172 counts, Falsifying Business Records in the First Degree (Class E felony); 1 count, Criminal Solicitation in the Fourth Degree (Class A misdemeanor); 3 counts, Failure to File Sales Tax Returns (misdemeanor); 6 counts, Failure to File Motor Fuel Excise Tax Returns (misdemeanor); 1 count, Evasion of Taxes (misdemeanor); 1 count, Conspiracy in the Fifth Degree (Class A misdemeanor)
Gerald Friedberg a/k/a Morton G. Friedberg a/k/a Jerry Friedberg	62	306 West 80th Street New York, N.Y. and Place One Apartment #231 Plymouth Meeting Pennsylvania	Director of Marketing, Seaplane Shuttle Transport later known as Lewis Petrochemical and Trading Corp.	same as Levine except no Criminal Solicitation
Igor Porotsky	49	535 Ocean Parkway Brooklyn, N.Y.	Officer and shareholder, Travelers Petroleum Corp. and Montana Enterprises, Inc. and Semar Petroleum Corp.	same as Friedberg
Igor Roizman a/k/a Jerry Ross	47	345 Webster Avenue Brooklyn, N.Y.	same as Porotsky	same as Friedberg
Nicky Dozortcev	21	2612 West Street	same as Porotsky	2 counts, Grand Larceny; 168 counts, Falsifying Records; 1 count, Failure to File Sales Tax Returns; 2 counts, Failure to File Excise Tax Return; 1 count, Tax Evasion; 1 count, Conspiracy

Joseph Galizia a/k/a/ Joe Glitz	44	12 Cherry Lane Lynbrook, N.Y.	Business Advisor to Sheldon Levine; settled disputes on Levine's behalf within the gasoline industry	same as Levine
Gerald Teich a/k/a Jerry Teich	45	97 Lotus Oval North Valley Stream, N.Y.	Accountant and financial advisor to Levine, Friedberg Porotsky, Roizman and Galizia	same as Levine

LIST OF CORPORATIONS INVOLVED IN "GREEN STAR CONSPIRACY"

CORPORATION, OFFICERS	ADDRESS	LICENSES	ALLEGED ROLE IN CONSPIRACY
Green Star Petroleum, Inc. Stanislowa Korsakowska	351 Hempstead Turnpike West Hempstead, NY 283 Greenwich Avenue Greenwich, CT (mail drop) 1441 Broadway New York, NY (mail drop) One Penn Plaza New York, NY (mail drop)	motor fuel distributor, State of Connecticut	purchased gasoline from Seaplane/Lewis; imported gasoline from New Jersey into New York; resold to No Brand and Snug Harbor
No Brand Petroleum, Inc. Sheldon Levine	425 Broadhollow Road Melville, NY (until 3-85) 445 Broadhollow Road Melville, NY (after 3-85)	none	purchaser of most of gasoline imported by Green Star; resold to Semar and others
Snug Harbor Fuel Corp. Sheldon Levine	same as No Brand	none	purchased some of Green Star gas; resold to Semar and others
Seaplane Shuttle Transports, Inc., later known as Lewis Petrochemical and Trading Corp Gerald Friedberg	80 Riverside Drive New York, NY	motor fuel distributor, State of New Jersey	primary source of gasoline purchased by Green Star
Semar Petroleum Corp. Igor Porotsky Igor Roizman Nicky Dozortcev	175-01 Rockaway Blvd. Jamaica, NY	none	purchased gasoline from No Brand and Snug Harbor; sold through its own service stations and resold to other retailers
Travelers Petroleum Corp. same as Semar	66-59 Saunders Street Rego Park, NY	none	unclear
Montana Enterprises, Inc. same as Semar	351-57 Hempstead Turnpike West Hempstead, NY	none	predecessor to Green Star as importer of gasoline

LOCATIONS WHERE SEARCH WARRANTS WERE EXECUTED -- FEBRUARY 13, 1986

The business offices of Sheldon Levine, 445 Broadhollow Road, Suite 229, Melville, New York, and his home;

The homes of Joseph Galizia, Gerald Teich and Gerald Friedberg;

The business office of Lewis Petrochemical and Trading Corp., located at 80 Riverside Drive, New York, New York;

A location in Brooklyn utilized by Igor Porotsky and Igor Roizman as a business office at 75 Wythe Avenue, Brooklyn, New York;

The business offices of a gasoline wholesaler known as Energy Makers of America located at 6 Xavier Road, Suite 710, Yonkers, New York;

The business offices of a gasoline wholesaler known as O.B. Enterprises, Inc. located at 224 Route 109, Farmingdale, New York;

The business offices of a gasoline wholesaler known as Jolona Enterprises located at 402 Warren Street and 68 Water Street, Hudson, New York; and

The business offices of a gasoline wholesaler known as Belfa Enterprises, Inc. located at 66-59 Saunders Street, Rego Park, New York.

Chairman PICKLE. Our last panel will be: Mr. Tom Potter, Mr. Jack Blum, Mr. Carl Bolch, and Mr. Richard White.

Our first witness is Mr. Tom Potter, Sr., president of the Tom Potter Oil Co., Morehead City, NC.

The second witness will be Mr. Jack Blum, general counsel for the Independent Gasoline Marketers Council.

Next will be Mr. Carl Bolch, Jr., vice president of the Society of Independent Gasoline Marketers of America.

And then we have Mr. Richard White, vice president, marketing, of the Marathon Petroleum Co.

We will start with Mr. Potter. We appreciate you staying with us. We haven't had a chance to eat lunch yet, but we felt we better go on through than try to come back in the afternoon when other votes will be taking place.

First, Mr. Potter.

STATEMENT OF TOM POTTER, SR., PRESIDENT, PETROLEUM MARKETERS ASSOCIATION OF AMERICA, AND PRESIDENT, TOM POTTER OIL CO., MOREHEAD CITY, NC, ACCOMPANIED BY PHILLIP R. CHISHOLM, EXECUTIVE VICE PRESIDENT, PETROLEUM MARKETERS ASSOCIATION OF AMERICA

Mr. POTTER. Mr. Chairman, my name is Tom Potter, Sr., and I am an independent petroleum marketer from Morehead City, NC.

After listening to much of the testimony this morning, I must tell you that I feel pretty stupid. I have been in this business 40 years. I took it over from my father, and Lord and the government willing, my son will soon take it over from me.

I am president of the Petroleum Marketers Association of America, representing small businessmen who sell half the gasoline, 60 percent of the diesel fuel, and three-quarters of the home heating oil used in this country.

The reason I feel pretty dumb is that I have sat here this morning and heard a convicted criminal, Federal Government officials, and State government officials tell everyone how prevalent evasion is and how easy it is to accomplish. Can you imagine that I was stupid enough to pay almost $2 million in State and Federal excise taxes last year? If all of this was going on around me, I must have been asleep for almost 40 years.

In all seriousness, Mr. Chairman, I strongly resent the implications by some that evasion is a way of doing business in this industry or that everybody knows it is going on and are participating in evasion. From my own business perspective and from my active participation as president of PMAA, I can state categorically that simply is not so. That is not to say that evasion does not exist. It certainly does. And I can tell you that no one is more interested in putting an end to that evasion than I and the 11,000 marketers PMAA represents.

What is the level of evasion? There are no hard numbers, but we highly suspect some of the more outlandish estimates offered today. If these estimates were true, then there would have to be considerably more gasoline sold than any Federal data base reports being consumed. But, any evasion is too much in terms of its competitive impact on the legitimate independent petroleum marketers, and it must be stopped.

Mr. Chairman, you asked in your opening statement if the Federal Government efforts have been sufficient to end evasion. Absolutely not. Many of my colleagues tell me that their Federal excise tax returns have never been audited. Many report not being audited for 15 years or more. There is no sense of having a cop on the beat ready to nab someone who violates the law.

I also resent the suggestions by some that the way to cover up the IRS's shoddy enforcement efforts is to change the law and allow just refiners or importers to collect the tax. I resent that because that so-called simple solution gives refiners a substantial competitive advantage over independent marketers with whom they compete. You can change the law in any manner you like, but whatever system you devise there will be ways to evade it, and those persons whose intent it is to violate the law will find those ways.

There is only one solution to this problem: There must be stronger enforcement on the part of the IRS and the Justice Department. If the problem is as great as the subcommittee has been led to believe, then a few more dollars in enforcement would be well spent.

Our prepared statement makes specific recommendations on what steps should be taken to end evasion. In addition to enforcement, we recommend more information sharing between the States and the Federal Government. We recommend that it be made more difficult to obtain a producer's license. We also recommend adoption of the Pickle amendment to the tax reform bill as a means of ending diesel tax evasion.

The oil industry, like many other industries, is intensely competitive. What makes this industry different is that the manufacturers of the retail products, the refiners, compete directly at wholesale and retail with their distributors and dealers. Therefore, any government action which grants any particular segment of the industry a competitive advantage in the marketplace is a serious concern to PMAA; and allowing refiners solely to collect and remit the Federal excise tax would grant them such a competitive advantage over independent marketers.

Currently, marketers and refiners pay Federal excise taxes on what they sell versus what they purchase. This is important for several reasons. It allows marketers the opportunity to pay the taxes only after the product is sold and the money for those taxes has been collected.

Second, marketers do not pay taxes on gallons lost through shrinkage, evaporation, and meter variation.

Third, marketers do not pay taxes on their inventory until it is sold. This is important because marketers are the prime source of secondary storage in this country. Refiners would have other competitive advantages over marketers.

Tax-exempt users such as local governments may wish to buy from refiners who can continue to sell them tax-free rather than from marketers who will have already paid the tax to their supplier.

It would also be virtually impossible for marketers to blend ethanol if they had to pay the tax directly to the refiner.

PMAA is committed to assist the Congress, the IRS, the Justice Department, and any other agency in ending excise tax evasion. However, we cannot stand by and watch a solution being adopted which may or may not solve the problem, but which does substantially reduce the competitive viability of marketers versus refiners.

Thank you for the opportunity to appear this morning, Mr. Chairman.

[The prepared statement follows:]

Statement of Tom Potter, Sr., President, Petroleum Marketers Association of America

Good morning, Mr. Chairman and members of the subcommittee. My name is Tom Potter, Sr. I am President of Tom Potter Oil Company, a small petroleum marketing company, which has annual sales of approximately 10 million gallons of gasoline, diesel fuel, and home heating oil throughout eastern North Carolina.

I am appearing today in my capacity as President of the Petroleum Marketers Association of America (PMAA), formerly the National Oil Jobbers Council. PMAA is a federation of 41 state and regional trade associations representing some 11,000 independent petroleum product marketers throughout the country. Those 11,000 marketers sell over half the gasoline, nearly 60 percent of the diesel fuel and three quarters of the home heating oil consumed in America. Although virtually all of those marketers are small businessmen, collectively their total assets would rank them 17th on Fortune 500's list of companies ranked by assets.

The issue before the subcommittee today -- excise tax evasion -- is of major importance to independent petroleum marketers. The companies represented by PMAA are largely family businesses in the second or third generation of operation. I, myself, am a second generation marketer. My son is very active in the business and I fully expect he will assume control of the business entirely within the next few years.

As the most efficient and price competitive segment of the petroleum industry, independent petroleum marketers abhor any unethical or illegal practices which might give a competitor an unfair advantage in the marketplace. This abhorrence is more than simply a moralistic judgement. Its practical application is that any disreputable competitor who fails to pay either the nine cents-per-gallon federal excise tax on gasoline or 15 cents-per-gallon federal tax on diesel fuel has a substantial competitive advantage vis a vis the thousands of legitimate motor fuel marketers.

PMAA, as an association, has taken a strong stance against excise tax evasion. Our Board of Directors passed a resolution last year which condemned excise tax evasion and urged that action be taken to eliminate it whenever it occurs (see Attachment I). We have since met with IRS officials on several occasions and have also advised the marketers we represent of possible ways to detect excise tax evasion and how to report suspected evasion to IRS officials (see Attachment II).

Our interest in ending excise tax evasion if it is found to be a substantial problem is unequivocal. If it is determined to be a substantial problem then solutions must obviously be found. In a moment I will suggest what some of those solutions might be. We do not believe, however, that the answer to any tax evasion problem is to give a competitive advantage to refiners by allowing them to collect and remit all gasoline excise taxes directly to the federal government, as some have suggested. This would not only be unfair to many marketers, but it would also jeppardize the continued viability of the substantial number of marketers who compete directly with refiners.

This morning I would like to elaborate on how the petroleum marketing industry operates; discuss how excise taxes are currently collected and remitted to the federal government; discuss the extent to which we believe excise tax evasion to be a problem; and finally, offer possible solutions to deal with excise tax evasion.

THE PETROLEUM MARKETING INDUSTRY:

The petroleum marketing industry is very complex with many interrelationships between various participants at different levels. The attached chart provides a simplistic design of how gasoline and diesel fuel are distributed from the refiner level to the retail consumer.

Several things should be noted from this chart. First, the vast majority of the petroleum products used in this country are produced by domestic refiners. Less than six percent of the gasoline used by Americans is refined in another country.

Secondly, there is intense competition for retail sales. The motorist or other retail purchaser has several options. The motorist can purchase from a station owned and operated by a refiner or an independent marketer (jobber or chain retailer); or he can purchase from a station operated by an independent dealer. The dealer may own the station directly or he may lease it from a refiner or jobber.

While most motorists are probably not interested in who owns or operates a particular station, it is important for policymakers to understand that petroleum marketing is one of the few industries where the manufacturer of a product, in this case gasoline and diesel fuel, competes directly with its customers for business. It is not unusual for a jobber, chain retailer or other marketer to find that one of their largest sources of competition is the company that supplies them their product. One can, therefore, understand the importance of not taking any governmental action which provides any segment of the market an unfair competitive advantage over any other.

In recent years this intense level of competition has had two major effects. The first has been a positive impact on consumer prices. Retail prices for gasoline have fallen from $1.388 in March of 1981 to 92.7 cents in May of 1986.

It has also offered consumers a range of options in purchasing gasoline. The consumer can buy gasoline from a branded station (one which carries a major oil company trademark) or a private brand station. He can pay with a credit card or get a discount for cash. He can buy milk, bread, eggs and soft drinks, or he can get his car tuned up, lubricated, and washed. He can pump his own gas or pay more for full service.

The second effect which has not been positive, at least from an industry perspective, is the decline in the number of participants in the market. PMAA estimates that over 6,000 marketers in business in 1980 are no longer in business today. This loss is coupled with the tens of thousands of retail station dealers, and the over 100 refineries which have shut down in the same time period. There are even fewer major oil companies today than there were five years ago.

One of the questions frequently asked is why refiners choose to sell through marketers (jobbers and chain retailers) rather than through their directly controlled outlets.

The answer to that question lies in the inherent efficiency of the independent marketer. Marketers, because of their closeness to the customer, their lower fixed overhead, their ability to operate on smaller margins, their knowledge of local markets, and their lack of cumbersome bureaucratic procedures typical of large corporations, have distinguished themselves as being the lowest cost, most efficient operators in the industry.

Independent marketers have long been noted for bringing about many of the innovations which are now commonplace in today's market. Self service, convenience store and car wash tie-ins, automated fueling facilities, and many other marketing innovations are directly traceable to the marketer who sought to build the proverbial "better mousetrap". As a result, independent marketers now sell over half the gasoline and nearly 60 percent of the diesel fuel consumed in America.

EXCISE TAX COLLECTION PROCEDURES:

Currently the federal government imposes an excise tax of nine cents-per-gallon on the sale or use of gasoline by a producer or importer. This rate has been in effect since April 1, 1983. Previously the rate was four cents-per-gallon. The term producer includes, in addition to one who actually produces or refines gasoline, wholesale distributors and chain retailers. A wholesale distributor is defined as any person who is engaged in the business of selling gasoline to producers (including other wholesale distributors), to retailers, or to users of gasoline who purchase in bulk quantities for delivery into bulk storage tanks.

In 1984, the law was amended to allow chain retailers to register as producers. A chain retailer is defined as any person who purchases gasoline from a producer and distributes it to ten or more retail gasoline stations under his common management. An importer is any person who withdraws gasoline from a customs-bonded warehouse for sale or use in the United States.

One should note that refiners and importers are required to collect and remit the excise tax to the federal government (i.e. register as producers). Wholesale distributors and chain retailers are not required to collect and remit this tax, but if they elect to do so, they must register.

Some marketers, mostly smaller ones not in markets where they compete directly with refiners, choose not to register as a producer. In these instances, they pay the excise tax directly to their supplier as part of the invoice price. Most marketers, however, do elect to register as a producer and therefore collect and remit the federal excise tax to the government.

WHY MARKETERS COLLECT AND REMIT FEDERAL EXCISE TAXES ON MOTOR FUELS:

As small businessmen, independent marketers loathe government paperwork. Therefore, it may seem anomalous to some that these same marketers would choose to burden themselves with additional paperwork in collecting and remitting the federal excise tax, when they could avoid the whole process by paying the tax directly to their refiner/supplier.

Those who choose to remit directly to the federal government do so for several reasons. Many of these are related to the fact that the marketer is able to pay taxes on gallons he sells rather than on gallons he purchases. This offers considerable advantages. First, it has a positive effect on cash flow in that marketers pay for the product and the excise taxes separately. Excise taxes must be paid every 14 days to the federal government, while payment practices with supplying companies vary considerably, with almost none allowing that much time. Requiring a marketer to pay the tax up front to the refiner would have a devastating effect on the independent marketer/remitter.

For example, a marketer with a consistent inventory level of one million gallons would be required to pay an additional $90,000 for the gasoline to build that inventory. This $90,000 can now be used by the marketer to invest in additional product or in station upgrades or to replace underground tanks. If he paid the tax at time of purchase, the positive cash flow effect would revert to the refiner. In addition, those marketers who deal in pipeline tenders would be paying taxes on millions of gallons of products they may not receive for several weeks.

Secondly, as a temperature sensitive, perishable product, gasoline is often lost to shrinkage, evaporation or meter variation during handling. Paying the tax up front to the supplier would require the marketer to pay taxes on those gallons which, though purchased, do not exist and therefore cannot be sold. Some states allow marketers as much as a three percent shrinkage allowance to account for product lost through shrinkage or evaporation. The National Bureau of Standards (NBS) also has established minimum tolerances to allow for product handling, recognizing that such an allowance is commonly accepted in the industry. These tolerances are generally based on the age of the loading rack metering equipment.

A third reason why marketers prefer to pay taxes on what they sell versus what they buy relates to the fact that marketers provide an important source of secondary storage of petroleum products. By PMAA estimates, marketers have bulk storage capacity of 1.6 billion gallons. This does not include storage at retail outlets owned by marketers which may be as much as four billion gallons. Product that is put into these storage tanks may not be sold for several weeks. Thus, the marketer is paying taxes on gallons he may not sell until considerably after the time he is required to pay his refiner/supplier. This would have a significant adverse impact upon our segment of the industry. Assuming marketers kept their tanks half full, this would mean a cost of $252 million to marketers as a group, or over $24,000 for the average marketer. At 12 percent interest, the cost of that money would be over $32 million per year for the industry or over $3,000 per year for the average marketer. This is an industry where the median motor fuel marketer earned less than $19,000 after taxes in 1985. Such increased costs would undoubtedly have a negative effect upon marketers' ability to maintain adequate secondary storage.

Finally, marketers elect to be producers because of their credit lines with their suppliers and banks. The credit lines are based on dollars, not gallons. Implementing federal excise tax collections at the refiner level in today's market would be akin to a 16 percent increase in prices paid by marketers and a commensurate decrease in the number of gallons they would be allowed to purchase under existing credit lines. Such a tightening of credit lines on marketers would mean they would have to tighten credit lines with their customers. This could become particularly harmful to farmers because independent marketers supply a substantial amount of agricultural fuel consumed today. Given the nature of today's farm economy, additional credit restrictions on fuel purchases are not something farmers would view positively. If the states choose to follow the federal lead, the negative impact on the marketer and his customers would in most cases be more than double.

Many of these factors might not be as important if marketers were not in direct competition with refiners for marketshare. Taking these advantages away would give refiners an inherent unfair competitive advantage in the marketplace.

There are other competitive reasons why marketers elect to be producers and thus collect and remit the excise tax. Many tax exempt purchasers such as Indian reservations, municipal governments, commercial fishermen, etc..., currently buy their gasoline from independent marketers who serve their local communities. If the tax collection and remittance process is changed, then marketers may lose these customers, who will see the obvious advantages to buying tax exempt from a refiner rather than from a marketer who has had to pay the tax up front.

Additionally, a marketer's ability to blend ethanol into gasoline to make gasohol would be seriously hindered since he would no longer be able to take advantage of the excise tax credit which is currently available to blenders of alcohol fuels. PMAA supports the total elimination of the gasohol exemption, but as long as it is in force, those marketers who blend product should continue to be allowed to do so.

The attached chart, in addition to showing the gasoline distribution process, also illustrates the various levels at which excise taxes are collected. As can be seen in terms of tax collection and payment, marketers are on the same level as refiners -- they pay the tax on gasoline once the product is sold. Taxes on sales through jobber direct-operated stations, through chain retailers and through refiner direct-operated stations are not collected until the gasoline is sold to the motorist.

Once the excise tax is collected on gasoline, marketers have 14 days after the semi-monthly period in which to remit the tax to the government. This essentially means that excise taxes are due on the 14th day of the month for gasoline sold between the 15th and 30th day of the previous month. Taxes are due on the 29th of the month for sales made between the 1st and 15th day of the same month.

Up to this point discussion has centered strictly on procedures applicable for gasoline. Diesel fuel collection and remittance procedures are completely different. Diesel fuel is a retail tax. It is collected at the retail level and remitted by the retailer.

The primary reason for this is two-fold. First, there are numerous tax exempt uses of diesel fuel, including agriculture and other off-highway uses. Secondly, diesel fuel is fungible as a product with home heating oil, which is not taxable. Therefore, policymakers deemed it most appropriate to collect diesel fuel excise taxes at the point of sale to the end user so that tax exempt uses could be determined at the level closest to the purchase.

The procedure to remit the diesel tax to the federal government is also considerably different from gasoline. Petroleum marketers with direct retail sales of diesel fuel are required to remit the tax nine days after the semi-monthly period. Therefore, taxes on diesel sales between the 1st and the 15th of the month are due on the 24th day of the month. Taxes on sales between the 16th and the 30th day are due on the 9th day of the following month.

REPORTS OF EXCISE TAX EVASION:

In recent months, there has been much concern over potential motor fuel excise tax evasion. This concern was brought to public attention last November when NBC Nightly News ran two special segments on organized crime's involvement in excise tax evasion, particularly in the New York market. More recently, the Federal Highway Administration has also expressed concern about the possible loss of revenue from the Highway Trust Fund resulting from excise tax evasion.

PMAA shares these concerns. If evasion is occurring, the innocent marketer -- remitting the tax properly -- is at a very serious disadvantage in the retail market. Marketers in some areas of the country have expressed concerns about potential excise tax evasion in their respective markets. Most of these concerns have involved reports of evasion on diesel fuel or on state excise taxes. PMAA has received few complaints about federal gasoline excise tax evasion.

In response to these marketer complaints, PMAA has talked with IRS officials about the need to create a higher enforcement visibility so as to eliminate or to reduce significantly any evasion which may be occurring. PMAA has also advised marketers on how to report excise tax evasion to the IRS if they suspect it is occurring.

A cooperative project between the IRS and the National Association of Tax Administrators (NATA) substantiates marketer concerns about diesel tax evasion. States participating in this project were California, Florida, Maryland, Pennsylvania and South Carolina.

Upon conclusion of the cooperative test program, IRS reported that the test program resulted in a sharp increase in the per return yield from IRS diesel fuel tax audits. This increase reportedly reflected the discovery of nonfiling, under-reporting, and the failure of taxpayers to collect the recently imposed higher federal excise tax rates. The audits also produced five criminal referrals by IRS and two criminal referrals by participating states. Interestingly, the participating states reported audit yields that were generally comparable to their regularly performed audits. A newsletter of the National Association of Tax Administrators reported that this result was to be expected "since state diesel fuel tax programs have been more extensive than IRS' program has been in the past..."

The recommendations coming from this project stressed increased state and IRS cooperation in sharing information. One recommendation was that annual and semi-annual meetings of IRS District and state audit management personnel should be held at which audit strategy and plans would be shared. A second recommendation was for states to identify fuel tax returns by federal employer identification numbers or social security numbers in order to facilitate the exchange of information. The third recommendation was that states provide state registrants with information as to their obligations for reporting and paying federal motor fuel taxes. The final recommendation was to further examine the results of the test program with a view toward extending federal and state cooperation to all states and expanding the areas of cooperation.

This type of cooperative effort between the IRS and the states will be critical to eliminating excise tax evasion wherever it occurs. While marketers are generally willing to assist in this effort, it is oftentimes very difficult for a marketer to determine if what they are witnessing is excise tax evasion or the forces of competition working in the marketplace. This is because there have often been wide swings in price in various markets between what the spot market price is, what the unbranded rack price is, what the branded jobber buying price is, what the dealer buying price is and what the retail street price is. Therefore, a competitor's lower selling price might be the result of a lower purchase price rather than tax evasion.

To determine the extent to which evasion is actually occurring, one should avoid the use of anecdotal evidence which may, in fact, overstate or understate the actual magnitude of the problem. Instead, one should examine the overall numbers to determine the extent to which evasion may be occurring.

PMAA is not aware of any available data that would indicate gasoline excise tax evasion is such a serious problem that any action other than stepped up enforcement by IRS or more vigilant action against organized crime by the Justice Department is necessary.

Table I illustrates available data on excise tax collection for fiscal years 1984 and 1985. This table compares gasoline excise tax collections with the actual number of gallons of gasoline being produced in the same year, as reported by the Department of Energy's Energy Information Administration (EIA), and with the taxable gasoline sales reported by the states to the Federal Highway Administration.

TABLE 1

	FY84	FY85
Tax Collection (1)	$ 9,020,413,000	$ 9,062,630,000
Gallons Sold (2) (DOT)	105,715,910,000	107,989,840,000
Gallons Sold (3) (EIA)	107,034,350,000	101,931,210,000
Fed use (4)	229,451,754	219,371,544
Gasohol (5)	4,704,344,000	6,190,576,000
Total Potential (6) Taxable Gallons @$.09		
A)=2-4-5 (DOT)	100,782,114,246	101,579,892,456
B)=3-4-5 (EIA)	102,136,554,000	95,521,262,456
Total Potential (7) Taxes @$.09		
(A) (DOT)	$9,070,390,282	$9,142,190,321
(B) (EIA)	9,192,299,860	8,596,913,610
Tax on Gasohol (8)	$141,130,320	$185,717,280
Total (9) Potential Taxes		
(A) (DOT)	$9,211,520,602	$9,327,907,601
(B) (EIA)	9,333,430,180	8,782,630,990
Ratio of Actual Taxes to Potential		
1/9 (A) (DOT)	97.92%	97.16%
(B) (EIA)	96.65%	103.18%

(1) Source: IRS,SOI Bulletin.
(2) Source: U.S. Department of Transportation, Federal Highway Administration Highway Statistics Division.
(3) Source: Energy Information Administration, Petroleum Marketing Monthly, various issues.
(4) Source: Defense Fuel Supply Agency, Cameron Station, VA.
(5) Source: See 2 above.
(6) Total potential taxable gallons are defined as total gallons sold minus federal use and gasohol. Gasohol is excluded at this stage because it has a different tax rate.
(7) Total potential taxes at nine cents equals #6 times $.09.
(8) Tax on gasohol equals #5 times $.03.
(9) Total potential taxes equals #7 + #8. This represents the amount of tax that would be collected if only federal use was exempt. This number should be higher than actual collection because it includes large volumes of gasoline which are either tax exempt or subject to refund.

This data shows that the Highway Trust Fund actually collected slightly more excise taxes in FY 1985 than the EIA reports was produced or imported into the United States during the same year. This may be accounted for in part by the drawdown from inventories produced or imported in previous years.

Table I also shows that the Highway Trust Fund collected 97.9 percent of the taxes payable on the gallons reported by the various states to the Federal Highway Administration in FY 1984 and 97.2 percent in FY 1985. The small percentage not being collected may be accounted for in several ways, not the least of which is the tax exempt purchases made by local governments, commercial fishermen, Indian reservations and others, and allowances for evaporation and shrinkage.

Some of this difference may in fact be accounted for by tax evasion, but certainly not at the level that some persons have suggested or may try to lead the subcommittee to believe.

However, any excise tax evasion is too much and PMAA believes it must be halted.

SOLUTIONS TO EVASION:

PMAA believes that the solution to excise tax evasion lies in a four step program. First, there must be stepped up enforcement by both the IRS and the Justice Department. Violators must believe that punishment for excise tax evasion will in fact occur. Currently, marketers report to PMAA that there is little IRS presence in the field. Some have reported that their excise tax payment records have never been audited. One regional IRS official told a marketing official that he had several suspected violators as targets for investigation but as a result of recent directives from Washington to reduce travel, he would probably not be able to follow through with audits.

PMAA recognizes and appreciates the budget pressures which IRS and other federal agencies are facing under mandated Gramm-Rudman cutbacks. However, well targeted, well publicized audits would provide evidence that IRS is serious about uncovering and prosecuting excise tax evaders. Currently there is no sense of having a "cop on the beat" as a deterrent to evasion. If the evasion problem is as great as some believe, then these enforcement actions would more than pay for themselves.

To the extent that organized crime may be involved, the Justice Department must also become more vigilant in its enforcement efforts as well. If organized crime has, in fact, found a new way of increasing revenue through evasion of motor fuel excise taxes, then they will only be halted by strong, aggressive enforcement actions. They will not be deterred by technical changes in the collection process.

The second step in the process of halting excise tax evasion involves improved information sharing between the states and the IRS. Previously, PMAA alluded to a successful joint federal-state audit on diesel fuel excise tax evasion. Out of that effort came not only increased payment of diesel fuel excise taxes, but also agreements between state tax administrators and the federal government to work more closely together.

PMAA understands that a similar project is now underway for gasoline excise taxes. States participating in this project include California, Florida, Illinois, Louisiana, New Jersey and New York. Joint state and federal audit targets were to have been selected and examinations begun by May 1, and are to be completed by December 31, 1986.

Beyond the joint audits being performed, one of the other benefits of this project may be information being shared on ways to target and catch evaders. The state tax administrators reportedly described gasoline tax "daisy chain" operations and the registration and audit techniques used to discover these artifices. Audit leads which the states say they have used include the use of a post office box as a primary address, the lack of a previous relationship with the oil industry, vague information on purchases and sales, name and/or officer changes, sudden large increases in activity, and returns not signed, among others.

This project, as with the diesel fuel project earlier, constitutes the initial efforts in the development of a nationwide program of federal-state cooperation in the motor fuel tax field. The purposes of the test programs are to translate their results into cooperative programs which can be instituted in each state on a routine basis and which can be employed in discovery of large scale tax evasion whereever it may exist. IRS and the states are to be commended for these cooperative efforts and increased efforts should be encouraged.

PMAA's third recommendation is to make the process of obtaining a producer's license more difficult. In the state-federal cooperative effort discussed above, PMAA understands that the states told IRS officials that the licensing and registration process is the "first line of defense" against evasion. State registration program measures include fingerprinting of license applicants; requiring applicants to visit state offices for a personal interview; requiring social security numbers to be submitted on applications; and imposing personal liability on company officers for taxes owed. We believe that by more thoroughly screening applicants for producer licenses, that the process by which such licenses are given will separate legitimate distributors from those who may seek to avoid excise taxes.

The fourth PMAA recommendation deals exclusively with diesel fuel tax evasion, which we believe to be most prevalent. We urge adoption of the Pickle amendment in the House tax reform bill and the Stevens amendment in the corresponding Senate bill. These amendments give retailers the right to allow their suppliers to collect and remit the federal excise tax on diesel fuel.

Currently, many retailers are unaware that they even must remit diesel excise taxes to the federal government. They assume, as with gasoline, that taxes are included in the price of the product. Many other dealers, who are aware they must remit the tax, have asked their distributor to do it for them. These amendments will simplify significantly the diesel collection process and reduce the amount of tax not now being collected by the IRS.

PMAA believes these four recommendations will significantly reduce the level of excise tax evasion which may now exist. Others, however, who believe the problem to be much greater than do we, have suggested an alternative idea. They suggest that gasoline excise taxes be collected at the refiner level or upon first import into the country. As evidence of the success of such programs, they point to states which have adopted measures which require taxes to be remitted at levels above the distributor or chain retailer.

As PMAA stated earlier, many marketers who choose to obtain producers' licenses do so as a means of remaining competitive with their refiner suppliers. Taking this privilege away from marketers would thus provide refiners and importers a significant competitive advantage. States which have adopted modification of this program have recognized this fact and for the most part have adopted measures which lessen the overall competitive impact on marketers. In New York, for example, the tax is applied on first import of product into the state. Since there are no refineries in the state, refiners gain no competitive advantage over distributors because they must pay the tax when the product enters the state. Tennessee has a similar program and in that state the distributor does not pay the tax to the refiner until the refiner must pay the tax to the state.

PMAA does not believe the excise tax evasion problem is so serious as to require such a draconian step as allowing only refiners and importers to collect and remit the gasoline tax. Before even considering such a move Congress should first insist on seeing evidence that the problem is far more pervasive than existing evidence would indicate.

If at some point such evidence is forthcoming and Congress deems it necessary to raise the gasoline excise tax collection process to the refinery level, then PMAA makes the following recommendations.

(1) Marketers should not be required to pay the federal excise tax to refiners for 14 days after they purchase the product. This is consistent with current law and recognizes to some degree the turnover in marketer inventory so that marketers, like refiners, are not required to pay the tax before they have an opportunity to collect it.

(2) Refiners should receive a credit against excise taxes owed if a customer they supply goes out of business owing the refiner gasoline excise taxes. This should result in no loss to the Treasury since IRS is currently unable to collect the excise tax from a marketer who files bankruptcy.

(3) Everyone should be required to pay the federal excise tax on gasoline. Users who currently have tax exempt status for gasoline purchases should be required to apply for a refund from the IRS. Refunds not received on a timely basis should be subject to interest payments by the federal government. This would limit the competitive advantage refiners may have in serving tax exempt uses.

(4) The excise tax exemption for ethanol should be eliminated. If, however, the ethanol exemption is retained, marketers should be allowed to certify to their suppliers the amount of product they intend to blend with ethanol and be allowed to purchase that at the excise tax rate applicable to ethanol; and

(5) Marketers should be allowed to reduce the amount of excise tax they are required to pay by 1.5 percent. This is necessary so that marketers are not required to pay taxes on gallons that they never sell, but which are lost through evaporation, handling or shrinkage. Some states allow as much as three percent for shrinkage. There should be no loss to the Treasury from this provision since these are taxes on gallons which are not now being paid because they are never sold. Moreover, this provision places marketers on a more even footing with refiners who do not pay on gallons which they lose through evaporation and shrinkage. It also helps compensate marketers for the fact that they will be paying taxes on inventories which may not be sold and collected until weeks after the excise tax is due.

These recommendations are offered as a means to ensure that marketers are not placed at a competitive disadvantage vis a vis refiners.

SUMMARY:

PMAA appreciates the opportunity to testify on an issue of great importance to petroleum marketers, the federal government, and the Congress. In summary, we would like to reiterate several important points.

-- PMAA is unalterably opposed to excise tax evasion wherever it occurs and is willing to cooperate fully with the IRS, the Federal Highway Administration, and the Congress in ending such evasion. The thousands of legitimate marketers represented by PMAA have no tolerance for the disreputable operators who seek a competitive advantage through illegal means.

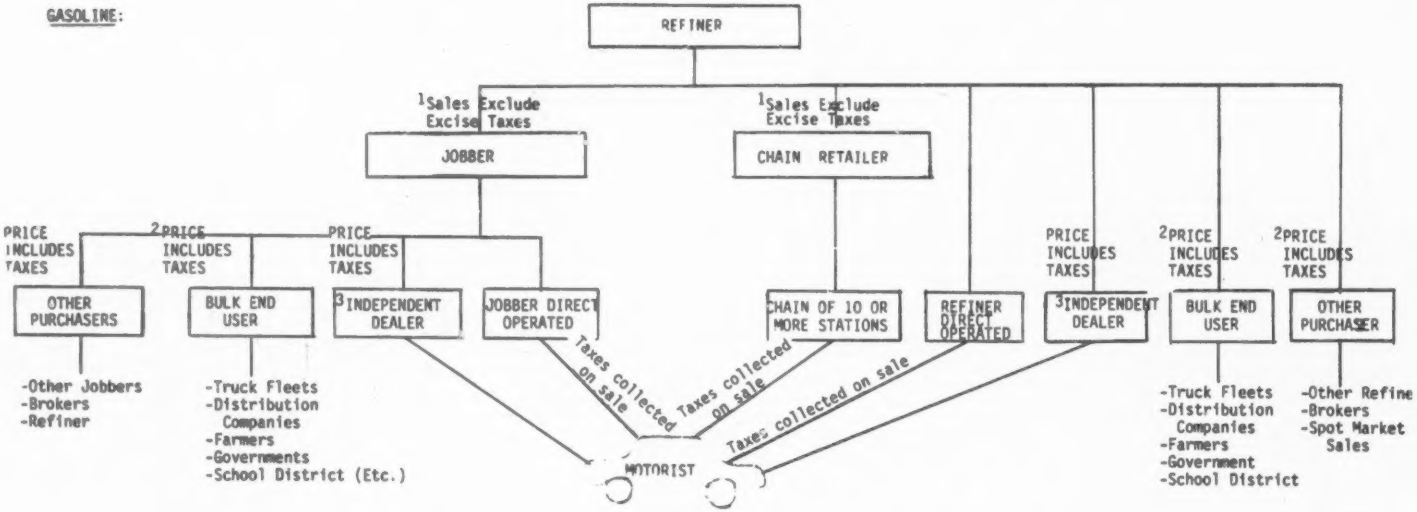
-- Evasion can best be addressed by stepped up enforcement by both the IRS and the Justice Department; greater levels of information sharing between state and federal officials; making the process of obtaining a producer license more difficult; and adoption of the Pickle-Stevens amendment to the tax reform bill which allows distributors to collect the diesel fuel excise tax from retailers and remit it directly to the federal government.

-- Before more radical steps are taken, additional data must be forthcoming to indicate that the problem is so pervasive that it cannot be dealt with by the steps outlined above. In no event should additional action be taken until the states and the IRS finish their cooperative project on gasoline tax evasion at the end of this year.

--If Congress receives additional information documenting widespread evasion, and determines that changes in the collection process are necessary, then PMAA hopes such changes would encompass PMAA's five recommendations which include: (1) allowing marketers to pay the tax to refiners every 14 days; (2) allowing refiners a credit for uncollectible excise taxes; (3) requiring all tax exempt users to apply for excise tax refunds from the IRS; (4) allowing marketers a 1.5 percent shrinkage allowance for gallons purchased from refiners; and (5) allowing marketers that purchase gallons used to blend ethanol, to be credited for those gallons blended, unless the ethanol credit is totally eliminated. These provisions would significantly lessen the anticompetitive impacts this proposal would otherwise have on marketers.

PMAA thanks the subcommittee for its consideration of our views and I will be happy to respond to any questions you may have.

GASOLINE:


REFINER
1Sales Exclude Excise Taxes
JOBBER
1Sales Exclude Excise Taxes
CHAIN RETAILER
PRICE INCLUDES TAXES
OTHER PURCHASERS
-Other Jobbers
-Brokers
-Refiner
2PRICE INCLUDES TAXES
BULK END USER
-Truck Fleets
-Distribution Companies
-Farmers
-Governments
-School District (Etc.)
PRICE INCLUDES TAXES
3INDEPENDENT DEALER
JOBBER DIRECT OPERATED
Taxes collected on sale
CHAIN OF 10 OR MORE STATIONS
Taxes collected on sale
REFINER DIRECT OPERATED
Taxes collected on sale
PRICE INCLUDES TAXES
3INDEPENDENT DEALER
2PRICE INCLUDES TAXES
BULK END USER
-Truck Fleets
-Distribution Companies
-Farmers
-Government
-School District
2PRICE INCLUDES TAXES
OTHER PURCHASER
-Other Refine
-Brokers
-Spot Market Sales
MOTORIST

[1] Most Jobbers and Chain Retailers buy from a refiner at a price excluding taxes. Some, mostly smaller marketers choose to pay the tax in the refiner's invoice price.

[2] Sales to other purchasers and bulk end users include the tax unless the purchaser has a tax exempt status (i.e. local governments, school districts, indian reservations, commercial fishermen)

[3] Independent dealers are independent businessmen who either own their own station or lease it from a refiner Sales to dealers are sales by the refiner or jobber to independent third parties

ATTACHMENT I

RESOLUTION

To Urge Action to Combat Petroleum Product Excise Tax Evasion

WHEREAS, reports of petroleum product tax evasion are on the increase;

WHEREAS, these reports are receiving national attention, and were featured recently in a two-part expose on NBC Nightly News;

WHEREAS, petroleum product excise tax evasion is harmful to the image of the petroleum marketing industry and destroys fair competition; and

WHEREAS, petroleum product excise tax evasion deprives both federal and state governments of crucial sources of revenue.

NOW, THEREFORE BE IT RESOLVED that PMAA deplores such activity and is committed to halting petroleum product excise tax evasion wherever it occurs.

BE IT FURTHER RESOLVED that PMAA as the national association representing independent petroleum product marketers study all possible ways to address this problem and to eliminate petroleum product excise tax evasion.

BE IT FURTHER RESOLVED that PMAA staff prepare recommendations on steps that can be taken to address this problem by PMAA, its members associations and the individual marketers it represents.

ATTACHMENT II

MEMORANDUM

DATE: February 13, 1986

TO: Association Executives, Motor Fuels Steering Committee

FROM: Barbara Faulkner, Vice President for Policy and Legal Affairs

RE: Petroleum Products Tax Evasion

On January 31, 1986 the PMAA Board of Directors passed the attached resolution from the Motor Fuels Committee deploring petroleum product excise tax evasion. PMAA staff is currently preparing recommendations on steps that can be taken to address this problem, in accordance with the Board's direction. In the meantime, however, many marketers have requested information concerning how tax evasion can be dealt with immediately.

Charles O. Wey, staff assistant to the Internal Revenue Service Assistant Commissioner for Criminal Investigations has advised PMAA that the federal IRS is seeking information which could lead to prosecution of excise tax evaders. Any marketer who has reason to believe that an individual may be engaging in such activity should telephone his or her federal IRS District Office and ask to speak to the Chief of the Criminal Investigations Division. The chief or agent assigned to handle the case will ask for as much documentation as possible, including names, addresses, telephone numbers, business records, eyewitness accounts, etc. The best information can generally be provided by an employee, or another individual who has personal knowledge of the activity. However, IRS also will conduct investigations based on less specific information, as long as the information furnished "is sufficient enough to be corroborated." IRS will accept information provided anonymously and without written documentation, but callers should be prepared to answer questions regarding their own prices and volumes, and terminal or harbor prices as a means of comparison with the alleged tax evader's prices. In addition, suspicious practices, such as a supplier's insistence on selling product tax-paid (where not required by law), deliveries in unmarked trucks or deliveries at unusual times of day or night, may also be accepted as evidence of possible evasion.

IRS will protect the confidentiality of individuals who wish to provide information anonymously. The only time the identity of an informant would be revealed, according to Mr. Wey, is when the case is brought to court and cannot be documented in any other way. However, this would be a highly unlikely occurrence.

If a federal investigation reveals evasion of state taxes, the IRS will share its investigation results with the state taxing authority. Federal/state agreements exist which allow free exchange of information, according to Mr. Wey.

Once the federal investigation is concluded, the results are handed over to the Department of Justice for prosecution.

Chairman Pickle. Thank you.

You leave no doubt about your feelings and your position. We will be talking to you a little bit further.

Now we will hear from Mr. Jack Blum.

STATEMENT OF JACK A. BLUM, GENERAL COUNSEL, INDEPENDENT GASOLINE MARKETERS COUNCIL

Mr. Blum. Thank you, Mr. Chairman.

My name is Jack Blum. I am general counsel of the Independent Gasoline Marketers Council, a trade association of nonbranded independent wholesalers and retailers of motor gasoline.

For the past 2½ years, our association has been aware of widespread evasion of State and Federal excise taxes on motor fuels and of irregularities in the payment of customs duties on cargoes of gasoline entering the United States from abroad. Individual members of the association and I, on behalf of the association, have repeatedly brought these issues to the attention of a wide range of law enforcement officials.

We are deeply dissatisfied with the response and with the quality of the tax investigative work. We are dismayed by the ability of companies that are the targets of this investigation to monitor the activities of the investigators. We believe that this subcommittee must send the law enforcement team working on the problem a signal that they had better take this problem seriously.

Our interest in tax evasion is intensely practical. The combined tax burden on a gallon of gasoline can be as high as 29 cents. If one competitor in the marketplace has a 29-cent cost advantage, there is no way that an honest marketer can compete with him. For legitimate taxpaying businesses, the gross margin is measured in pennies and the profits are frequently measured in mils.

Dishonest marketers can pay greater than market prices for cargoes of gasoline and sell the product for under market prices. That has been happening, and it has hurt the honest competitors.

In some markets—most notably New York Harbor and Florida—and submarkets served by those markets, including some of New England and the Southeast, companies were selling wholesale gasoline on a tax paid basis substantially below the market price. Further, the price some importers were willing to pay for cargoes of gasoline was higher than reported market conditions would permit.

For example, when one of our members attempted to negotiate contracts for imported cargoes, he found that the foreign suppliers were unwilling to accept the reports that he gave of market conditions, and told him they could get far more money for their products from other firms that were similarly situated. He knew that the number he was being given could not work economically. His experience was confirmed by others.

Variations on this theme were reported by association members operating in Texas, California, and Michigan.

During this period, our association was engaged in a debate before this committee over gasoline imports. As committee members may recall, the independent refiners were complaining about the level of gasoline imports and how those imports were destroying competition, especially in the Northeast. When I privately compared the numbers we were using in our presentations with the number the refiners were using in theirs, it became clear that tracking imports by arriving ship yielded higher numbers than the official customs statistics. Further, if you looked at the prices some importers were charging their customers, rather than the reported cargo prices it did look like imports were bombing the market.

Knowing what I now know, I believe that a number of cargoes never made the official statistics and that the competitive problem was really a tax and tariff collection issue.

During this time, I began to hear about a major strike force investigation of the gasoline tax evasion which was underway in the eastern district of New York.

Curiously, I was told about this investigation confidentially by employees of companies that were dealing with the targets. They had picked up news of the investigation on a confidential basis from the executives of the targeted companies. Over the next year, these trade sources stayed ahead of the news reports on the investigation by several weeks. They knew about wiretaps and upcoming arrests. They passed the news to me that the "big boys" would not be touched and that the investigation would focus on the small fry.

These predictions have turned out to be startlingly accurate. The results of the investigation have been a few low grade prosecutions and the collection of a tiny fraction of the unpaid taxes. Instead of leaning on the low-level cheats to get the larger companies which have cooperated in—and have likely masterminded—the tax evasion, law enforcement officials have been squeezing midlevel evaders to find minor offenders on the lowest possible level.

One is reminded of the movie "Casablanca" when the inspector instructs his men to "round up the usual suspects." The result is great entertainment. It has not, however, rooted out the problem.

To fully understand what is happening, one must understand the way that the gasoline business works. Legitimate refiners, terminal operators and importers do not sell gasoline to newly formed wholesale companies with no established customers that have been set up by immigrants with no experience in the business. The new wholesaler would not have the credit standing to make the purchase and the supplier will know that the operation is not legitimate.

We are convinced that the wholesalers who were put in business as shell corporations were able to operate because their suppliers were, at the minimum, knowledgeable and cooperating.

It is also true that major oil company marketing executives have to be aware of significant cheating at their franchised retail units. If a station is selling 50,000 gallons of gasoline a month before the dealer begins running in nontax paid, bootleg gasoline, the addition of 25,000 gallons of bootleg supply to the dealer must mean lower monthly volumes for the major supplier. If widespread cheating is going on, sales volumes for the entire region will be way off.

The question which should be asked is: What do these suppliers know, and what role did their sales force play in the problem? So far, no one has asked it.

A few words are in order about our efforts to attract law enforcement attention to the problem. In May and June 1984, I spoke with the New York State attorney general's office and shared company specific information on problems in New York Harbor. I was assured that a major investigation was underway and that results would be forthcoming.

We later shared this information with officials of the Federal Trade Commission on the theory that the situation involved unfair competition and should be taken into account when they were considering the impact of several mergers then pending at the Commission. We were assured that the Commission had received information about the problem from State law enforcement authorities, and would take it into consideration.

We patiently waited for the investigations which were supposed to be underway to bear fruit. By December 1985, it was clear that the investigation was focused on people with last names ending with vowels and fly-by-night operations with owners who had recently got off the boat. The press was characterizing the problem as a Mafia operation which had been closed down. Worst of all, officers of some of the companies which had been targets were now boasting to their friends that they were "out of the woods."

On December 13, 1985, I met with John Keeney, Deputy Assistant Attorney General, Criminal Division of the Justice Department, to express my concerns. I reported the fact that one could learn more about the Justice Department investigation at the meeting of the New Jersey Fuel Merchants Association than anyone outside the Justice Department should ever be allowed to know.

I mentioned the fact that an attorney for the strike force had gone to work for one of the defendants and that the focus of the investigation was down to low level operators, not to the ringleaders. I was told to express my concern to the assistant U.S. attorney in the eastern district in charge of the investigation. I expressed some reluctance to do that in view of the fact that everything said in the investigation seemed to go right back to the targets.

Despite these reservations, I attempted to arrange a meeting to discuss the problem. No mutually convenient time could be arranged, and nothing further happened. I might add that after what I heard this morning, I am particularly upset because it seems clear to me that licenses were granted to people who never should have gotten them; that the State had to grant those licenses; that there has to be some degree of State involvement or knowledge in the fact that people were licensed to do wholesale business who were engaged in criminal activity; and the State officials are participating in the Government strike force investigation.

I think that one of the problems, one of the reasons information was leaking back to the street is this strike force, which was said to be a model, was so large that anyone wanting to know about the investigation could find out about it. You had every possible agency privy to the investigation, and that is an unacceptable situation when you know information is flowing back to the street.

You have been urged this morning to say that the problem is a problem of where the tax is collected. I submit you have heard about as damning an indictment of law enforcement generally as one can muster this morning.

It should be said that after 2½ years of investigation, the Department of Justice has gotten 12 convictions and recovered $12 to $14 million. I submit, given the size of the investigation, the description of it as a model investigation, and the discussion of how hard they have been working, it is a hell of a lousy work product, and some questions have to be asked about how hard a job they are doing. I think it is a case of a bloodhound who has a very bad sinus condition.

We as independent marketers do not want to be the people who pay the price for this failure of law enforcement. Our competitive position depends on the other guy paying taxes the way we do, and our competitive position depends on the tax being put on the gasoline at the level where it least disrupts competition, and we fully agree with PMAA that it ought to remain at the retail level but we insist that the investigators be asked, how come no results and how come questions like the points raised this morning, that the brothers of the former Governor was using funds as a conduit to a political campaign have not been raised in this Federal investigation which has kept State authorities as a full partner.

Thank you, Mr. Chairman.

[The prepared statement follows:]

STATEMENT OF JACK A. BLUM, GENERAL COUNSEL, INDEPENDENT GASOLINE MARKETERS COUNCIL

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We are deeply dissatisfied with the response and with the quality of the tax investigative work. We are dismayed by the ability of companies that are the targets of this investigation to monitor the activities of the investigators. We believe that this subcommittee must send the law enforcement team working on the problem a signal that they had better take this problem seriously.

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For example, when one of our members attempted to negotiate contracts for imported cargoes he found that the foreign suppliers were unwilling to accept the reports that he gave of market conditions, and told him they could get far more money for their products from other firms that were similarly situated. He knew that the number he was being given could not work economically. His experience was confirmed by others.

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I mentioned the fact that an attorney for the strike force had gone to work for one of the defendants and that the focus of the investigation was down to low level operators, not to the ringleaders. I was told to express my concern to the Assistant U.S. Attorney in the Eastern District in charge of the investigation. I expressed some reluctance to do that in view of the fact that everything said in the investigation seemed to go right back to the targets.

Despite these reservations, I attempted to arrange a meeting to discuss the problem. No mutually convenient time could be arranged and nothing further happened.

It is my understanding that the Federal Highway Administration and some parts of that law enforcement community are urging you to solve the problem by changing the level at which the tax is collected. As far as we are concerned that is an unacceptable cop-out. Changing the level of tax collection punishes honest wholesalers by increasing their working capital requirements and their risk of loss, seriously complicating their paperwork on exempt sales, and complicating their ability to use alcohol credit.

As far as we can tell there was no serious enforcement of the excise tax laws prior to Mr. Iorizzo's emergence as a celebrity. My members cannot recall routine audits by IRS on excise tax returns. We should not be asked to pay the price for this level of governmental negligence and incompetence.

Chairman **Pickle**. We will go on to the other witness.

Mr. Bolch.

STATEMENT OF CARL BOLCH, JR., FIRST VICE PRESIDENT, SOCIETY OF INDEPENDENT GASOLINE MARKETERS OF AMERICA, AND CHAIRMAN OF THE BOARD AND CHIEF EXECUTIVE OFFICER, RACETRAC PETROLEUM, INC., ATLANTA, GA

Mr. **Bolch**. My name is Carl Bolch, Jr., chief executive officer of Racetrac Petroleum of Atlanta.

I would like to make a few comments.

Our company Racetrac operates in 13 States, 287 retail outlets. We operate from Texas to Maryland. We do not operate in south Florida nor in New York.

I am not in a position to comment about south Florida or New York.

Chairman **Pickle**. What States do you operate in?

Mr. **Bolch**. Thirteen States that range from Texas to Maryland, including Florida and the States in between.

However, that does not include south Florida and it does not include New York.

We have about 150 suppliers at various times during the year that we buy gasoline from. We sell over 300 million gallons of gasoline per year. To my knowledge, in the area that we operate there is no tax evasion taking place that I am aware of.

I would think in the competitive position that we occupy in our industry, I would have some knowledge of that. Now I have heard about South Florida and New York, and I believe that.

In the area that I operate in, I have heard nothing.

I am here today representing, as its first vice president the Society of Independent Gasoline Marketers of America.

SIGMA is the national trade association of 289 gasoline retailers.

SIGMA opposes the proposed deletion of wholesale distributors and chain retailers from the definition of producer because it would: First, impose substantial economic burdens on our members and second, place them at a significant competitive disadvantage with our competitors.

SIGMA members play an important role in the retail gasoline marketplace. We introduced self service, high volume/low margin marketing and automated retail marketing. These innovations induced price competition in the domestic market for gasoline.

The gasoline excise tax is imposed upon the first sale of gasoline by a producer to a nonproducer. At first, the definition of producer was limited to refiners, but this created competitive problems because the taxable event is the first sale. The integrated company could delay tax payment until the first sale, even if this were at retail. The nonproducer could not similarly delay because it purchased the gasoline tax-paid. Thus, the integrated company had lower inventory carrying costs. Recognizing this, Congress included wholesale distributors and chain retailers in the definition of producer.

We, therefore, pay the tax at the same time as our refiner competitors. This assures us a level playing field.

The Federal Highway Administration is concerned that organized crime elements may be engaging in gasoline tax evasion. SIGMA members could not compete with such tax cheaters. Only in certain parts of the Northeast have SIGMA members reported tax cheating, which does not appear to be widespread. Therefore, we urge that Congress determine the extent of any abuse before changing the present procedures. If tax evasion is not significant, it may be better to improve enforcement.

I find it outrageous that no one in the administration can give us any extent of the cheating. I cannot understand auditors that cannot make some kind of compliance audits, some kind of statistical projections to give us some kind of idea of the extent of the problem. They seem to be unable to do this. Before we do anything, that should at least be a minimum requirement.

If Congress must alter the current law, it should not change the definition of producer. First, such a change would impose significant costs on us that would not be borne by our supplier competitors. For example, we would incur considerable additional financing costs.

At present, SIGMA members have built into their operations the time value of the excise taxes collected and held until remittance to the Government. We are able to avoid the cost of borrowing funds to finance the tax on gasoline inventory and can pass on significant cost savings.

The proposed change would eliminate this cash-flow and substantially increase inventory costs. Moreover, we would incur further costs by having to purchase inventory tax paid. Our refiner-supplier competitors would not experience a similar increase in inventory costs. As a result, our inventory costs would be significantly greater than those of manufacturers and importers, giving them a significant competitive advantage.

Second, manufacturers and importers would derive a significant advantage by being able to hold our money. We would be forced to transfer funds owed to the Government to our direct competitors which would be able to earn interest on these funds, allowing them to underprice us.

Third, altering the definition would virtually preclude us from selling to entities, such as State and local governments and farmers, which are exempt from the Federal gasoline excise tax. At present, we compete on a par with manufacturers and importers for this market because we can sell gasoline to these entities tax free.

In summary, changing the definition would have anticompetitive implications far beyond whether tax evasion is occurring. These anticompetitive implications suggest that Congress should consider alternatives.

There are two means by which tax cheating could be avoided or reduced: One, stricter enforcement, or, two, a change in existing laws. SIGMA favors stricter enforcement because it would not have any potentially adverse anticompetitive consequences.

If Congress decides that stricter enforcement is impractical and that it must alter the law, this change must not: One, recreate anticompetitive imbalances, or, two, impose a de facto tax on gasoline marketers. Either of these would have serious, negative consequences for independent marketers.

We operate in a market dominated by vertically integrated entities. We purchase from and compete with these companies. Thus, any change which affords them benefits not available to us, such as the use of funds, places us at a distinct competitive disadvantage. To eliminate this very disadvantage, Congress broadened the definition of "producer" under existing law.

Any change which denies marketers the use of funds available to them under existing law would constitute a de facto tax on us. Any change intended to reduce tax cheating, but which denies us the use of these funds, will result in a transfer to the Government of the time-use value of these funds; that is, a de facto tax. This would have serious, negative consequences for many marketers.

In conclusion, any gasoline excise tax collection mechanism should be competitively neutral. The current method has achieved this objective and benefited U.S. consumers, the U.S. economy, and the U.S. Government. No change should be made.

If a change must be made, it must: One, avoid giving an advantage to any segment of the oil industry, thus preserving a level playing field, and, two, avoid imposing an inequitable economic burden on the marketing segment of the gasoline industry.

[The prepared statement follows:]

United States House of Representatives
Committee on Ways and Means
Subcommittee on Oversight

Statement of Carl Bolch, Jr.
on Behalf of the Society
of Independent Gasoline Marketers of America

My name is Carl Bolch, Jr. I am Chairman of the Board and Chief Executive Officer of Racetrac Petroleum, Inc., of Atlanta, Georgia, and First Vice-President of the Society of Independent Gasoline Marketers of America, on behalf of which I appear today. My company, Racetrac Petroleum, Inc., owns and operates 250 retail gasoline outlets in 13 Southern states. SIGMA is a national trade association comprised of 289 independent marketers and chain retailers of motor fuels. SIGMA's members market refined petroleum products in all 50 states and account for approximately 20 percent of the U.S. retail market for motor gasoline. With respect to federal legislation, the association primarily focuses its attention on the competitive consequences of a bill. SIGMA strongly opposes any legislation which creates competitive advantages for particular classes of participants in the motor fuel markets.

The purpose of these hearings is to review the present method of gasoline excise tax collection. Under current law, gasoline excise taxes are collected and remitted to the government by gasoline "producers," defined to include not only manufacturers and importers but also wholesale distributors and chain retailers. As chain retailers and, in many cases, wholesale distributors of gasoline, SIGMA's members qualify as producers which collect and remit a significant portion of the total federal motor fuel excise taxes. This Subcommittee is examining whether the current definition of a gasoline "producer" should be changed to exclude wholesale distributors and chain retailers, thereby precluding them from collecting and remitting the excise tax.

SIGMA opposes the proposed change to the current definition of producer because it would: (1) impose substantial economic burdens on our members and (2) place them at a significant competitive disadvantage vis-a-vis other segments of the retail gasoline market. If Congress determines that a change in the present system of excise tax collection is necessary, it should consider other measures that will ensure a level playing field in the retail gasoline industry.

The Role of SIGMA's Members

SIGMA's member companies play an important role in the retail gasoline marketplace. We introduced such innovative marketing devices as self service, high volume/low margin marketing and automated retail marketing. These pioneering marketing concepts and superior systems of cost control induced price competition in the domestic market for gasoline. Independent marketers and chain retailers historically have been recognized as the most price competitive segment of the retail gasoline market.

The Present System of Collecting and Remitting the Gasoline Excise Tax

The gasoline excise tax is a levy imposed upon the first sale of gasoline by a manufacturer ("producer") of gasoline to an entity which is not a producer or an exempt purchaser. At first, the law generally restricted remitters of the tax to refiners, but this created competitive problems for the remainder of the industry. The problem existed because the taxable event for the imposition of the excise tax is the first sale. Since most refiners were integrated, the first sale could be to another refiner, to a terminal operator, to a wholesale distributor, or at retail. Thus, the integrated company could delay the payment of the tax in the distribution chain until the first sale, albeit even if this were at the retail pump. The non-manufacturer (non-producer) could not delay funding the excise tax until the retail pump because it had to purchase the gasoline tax-paid from the producer. Thus, the integrated company which retailed the gasoline had lower inventory carrying costs because it could delay payment of the excise tax while the non-producer could not. Recognizing this structural unfairness and the financial burdens placed on different segments of the same industry, Congress included wholesale distributors and chain retailers in the definition of producer.

As "producers" under the current excise tax law, SIGMA members do not pay tax on gasoline purchased from importers or from our refiner-competitors. Instead, they collect it on the first sale to a non-producer and remit the proceeds to the government. As a consequence, we pay the tax at the same time as our refiner-competitors which sell gasoline through their own stations. The current law thus ensures that manufacturers and importers do not enjoy an unfair competitive advantage through a tax payment time advantage over wholesale distributors and chain retailers. In treating wholesale distributors and chain retailers as producers, Congress specifically removed the uneven competitive implications of allowing an integrated company to pay its taxes at the retail pump while requiring the independent non-producer to pay its taxes at the time of purchase.

By ensuring that no segment of the gasoline industry is given an inventory carrying cost advantage over any other, the present law preserves the benefits of a level playing field for U.S. consumers of motor fuels.

Inadvisability of Changing the Definition of Producer

SIGMA is opposed to any measure that would alter the present definition of producer so as to permit manufacturers and importers, and not wholesale distributors and chain retailers, to purchase gasoline tax-free and sell it tax paid to wholesale and retail customers.

As an initial matter, we urge that Congress carefully consider whether any change in the current excise tax collection procedures is warranted. These hearings were prompted by concern expressed by the Federal Highway Administration that organized crime elements may be involved in the retail gasoline market for the purpose of engaging in tax evasion. SIGMA recognizes the potential gravity of such a situation. Indeed, SIGMA is concerned about this problem because SIGMA members could not compete with tax cheaters whose lower prices reflect illegal tax savings. However, many SIGMA members have not seen any indication of such activity in their markets. Only in a few areas, primarily certain parts of the northeastern United States, have SIGMA members reported concerns about tax cheating, and even there, cheating does not appear to be widespread. Therefore, we urge that Congress first determine the extent of any abuse of the present tax collection process before considering changing the present procedures. If tax evasion is not a significant problem, it may be much more cost effective simply to improve present enforcement mechanisms.

Even if Congress decides to alter the current law, it should not do so by changing the definition of producer. Such a measure would place wholesale distributors and chain retailers at a competitive disadvantage in several respects, to the detriment of U.S. consumers.

First, altering the definition of producer would impose significant costs on wholesale distributors and chain retailers that would not be borne by our supplier competitors. For example, we would be forced to incur considerable additional financing costs due to the adverse effect on our cash flow.

Because of the way the current tax collection process is structured, SIGMA members have built into their operations the time value of the excise taxes collected and held until remittance to the government. We use this cash flow in our operations to allow us to compete with integrated companies which also enjoy this advantage. As a result, we are able to avoid the cost of borrowing funds to finance the tax on gasoline inventory purchases and can pass significant cost savings on to consumers.

Altering the current definition of a producer would eliminate this cash flow and substantially increase costs of inventory. Not only would we lose the current benefit of the time value of the cash flow currently derived from excise tax collections, but also we would incur further economic costs in purchasing inventory because we would be forced to buy the gasoline "tax paid". As a result, we would be required to finance an increasing portion of our inventory. These additional financing costs would increase our costs of doing business significantly and thus hamper our ability to compete.

Our competitiveness would be hampered by the overall increase in our inventory costs, which our refiner-supplier competitors would not experience. Because we would no longer be able to purchase gasoline tax-free, we would be forced to pay considerably more for the supply that we maintain. As a result, our inventory costs would be significantly greater than those of manufacturers and importers, giving them a significant competitive advantage.

Second, manufacturers and importers would derive a significant advantage by being able to hold wholesale distributors' and chain retailers' money. Since we would be required to purchase gasoline "tax paid," we would be forced to transfer funds owed to the government to our direct competitors. These manufacturers and importers would be able to earn interest on these funds, allowing them to underprice wholesale distributors and chain retailers and thus threaten our continued viability.

Third, altering the definition of producer would virtually preclude wholesale distributors and chain retailers from selling to entities, such as state and local governments and farmers, which are exempt from the federal gasoline excise tax. At present, we compete on a par with manufacturers and importers for this market, because we purchase gasoline tax-free and thus do not incur any greater "tax costs" than other producers.

If the definition of producer were altered, it would be virtually impossible for anyone except a manufacturer or importer to sell to tax-exempt buyers. Manufacturers and importers could still buy gasoline tax free and thus sell it "tax free" to exempt purchasers. Wholesale distributors and chain retailers, by contrast, would have to pass on at least a portion of the tax that they paid in buying their supply and thus could not match the prices that manufacturers and importers could offer.

In sum, changing the definition of producer would create significant structural imbalances and distortions in the retail gasoline marketplace that have implications far beyond the problem sought to be addressed. The likely effects on the economy, consumers and the oil industry suggest that Congress should consider alternative measures to correct any perceived problems in the excise tax collection process.

If the Present Law Must be Changed, It Should Should be Altered in a Competitively Neutral Manner

There are two means by which tax cheating could be avoided or reduced: (1) stricter enforcement of existing laws or (2) a change in existing laws. SIGMA favors stricter enforcement of existing laws because such action would not have any potential adverse consequences for the competitive structure of the gasoline market.

If Congress decides that stricter enforcement is impractical and that it must alter the excise tax law, this change must be effected in a way that does not: (1) re-create competitive inbalances or (2) impose a de facto tax on gasoline marketers. The Committee must recognize that either of these results would have serious, negative consequences for independent marketers.

It is essential that Congress remember that we operate in a market dominated by vertically integrated entities. We purchase from and compete with these companies. Thus, any change in the excise tax which affords them benefits not available to us, such as the use of funds, places us at a distinct competitive disadvantage. It was to eliminate this very disadvantage that Congress broadened the class of entities entitled to collect and remit the gasoline excise tax under existing law. In changing the law, Congress should be careful to avoid duplicating the competitive inequity which gave rise to the broadening of the definition of producer.

The Committee also must recognize that any change in the current method of collecting the tax which denies marketers the use of funds available to them under existing law would constitute a de facto tax on us. Under existing law, we have the use of funds for a statutorily specified period. A change in the law, intended to reduce tax cheating, but which denies us the use of these funds will result in a transfer to the government of the time-use value of these funds, i.e., or de facto tax. Such a tax would have serious negative consequences for the economic viability of many marketers.

To avoid the unintended imposition of a tax on marketers, Congress must structure any change in the system in a manner which does not result in the transfer of these funds' time-use value. It would be grossly inequitable to penalize the entire marketing industry in an effort to eliminate tax cheating by a few disreputable entities.

Conclusion

In conclusion, it is important to understand that any mechanism used to collect the gasoline excise tax should be competitively neutral and avoid distortions in the retail gasoline market. The current method of gasoline excise tax collection has achieved these objectives and benefited U.S. consumers, the U.S. economy, and the U.S. government. The advantages of the present system suggest that no change should be made in the method of collecting the gasoline excise tax.

If a change must be made, it must: (1) avoid giving an advantage to any segment of the oil industry, thus preserving the benefits derived from a level playing field in the retail gasoline marketplace and (2) avoid imposing an unwarranted and inequitable economic burden on the marketing segment of the gasoline industry.

(The following was subsequently received:)

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September 11, 1986

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SEP 12 1986

Ways and Means
Subcommittee on Oversight

Hand Delivered

Ms. Beth K. Kuntz
Subcommittee on Oversight
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Ms. Kuntz:

The Society of Independent Gasoline Marketers of America submits the enclosed responses to the follow-up questions posed by the Subcommittee on Oversight on the gasoline excise tax evasion issue following the panel's July 15 hearing.

Sincerely,

Jeffrey L. Leiter

Enclosure

(1) What specific information do you have with regard to the extent and geographic location of gasoline excise tax evasion?

SIGMA has no specific information as to the extent and geographic location of gasoline excise tax evasion. Most SIGMA members questioned about this issue have responded that they have not seen evidence of gasoline excise tax evasion - - uncharacteristically low postings (either wholesale or retail) - - in their markets. However, SIGMA members, operating in Metropolitan New York, emphasize the competitive difficulties created by the gasoline excise tax evasion problems in the New York City area, and estimate that evasion of the Federal excise tax, including bootlegging schemes, could be as much as ten percent of gasoline sales. Moreover, these members believe that such evasion is a continuing problem in the New York City area.

a. What size and types of firms are involved?

SIGMA members, marketing in Metropolitan New York, suspect that cargo-size shipments of gasoline blending components are taking place at a terminal in New Jersey where products are blended and then shipped in barge and truckload quantities up and down the East Coast.

In addition, the busiest wholesale terminal on Long Island, owned by an independent terminal operator, has trucks lined up for hours to buy gasoline at "bargain" prices. Further, members indicate while they do not have specific information as to the sources of supplies, there are retail locations on Long Island, some of which are branded under the "flags" of major oil companies, that are posting regular grade of gasoline at 51.9 cents per gallon, which includes: 25 cents per gallon in taxes, margins for the retailer and wholesaler, as well as transportation and terminaling costs. Such retail postings on such a widespread basis are not the result of aggressive marketing.

(2) What further steps will you, as an industry, take to eliminate or reduce gasoline excise tax noncompliance?

The gasoline marketing industry can request more enforcement, prosecution and auditing of excise tax collections and remittances at both the State and Federal levels. Moreover, members of the industry promptly can provide information with regard to large shipments and can report suspicions of noncompliance by others when it is observed.

(3) We also hear about gasoline bootlegging where gasoline is imported into the U.S. or moved across State lines without notice. Among other things, bootlegging provides the system with untaxed gasoline which competes with honest business operations.

a. Who knows (or should know) what gasoline enters terminals undercover or at night?

Terminal operators obviously should be the best source of information about deliveries into their terminals. However, carriers -- pipelines, trucking firms, and barge and cargo shippers - - also could be a source of such information. For products imported into the United States, the United States Custom Service should be the best source of such information.

b. How big do you suspect bootlegging is in comparison to other gasoline excise tax evasions schemes?

As noted above, SIGMA does not have reliable estimates of bootlegging or other excise tax evasion schemes. However, SIGMA assumes that the bootlegging problem would be more prevalent along State lines, where product can be moved from one State to another to avoid State excise taxes.

(4) One way to address the noncompliance problem would be through administrative changes in additional enforcement efforts by Federal agencies (IRS, Justice, FBI).

a. What are your views on what further steps could be taken administratively to deal with the gasoline excise evasion problem? Federal level? State level?

More auditing by States, increased monitoring of the flow of products, and the sharing of information among the Federal government and State governments could help administratively to deal with the gasoline tax evasion problem. In addition, the penalties for such tax evasion could be made more severe and could include the confiscation of product if taxes have not been paid.

b. Could the U.S. Customs Service, FBI, or Justice Department do more by way of enforcement? If so, where and what?

Information from the United States Customs Service as to products imports and movements on water are critical to enforcement efforts at both the Federal and State levels.

(5) What could be done to enhance information sharing with the States?

The Federal government could help States through agreements which would permit the computer cross-checking of excise tax returns.

(6) With regard to proposals for earlier collections of gasoline excise taxes, what level of shrinkage allowance do States allow? Is 1.5 percent consistent with State allowances? What about the expansion of tax-paid gasoline? Should adjustments be made here as well?

SIGMA has not surveyed each States' excise tax law to determine shrinkage allowances. However, SIGMA members have indicated that a 1.5 percent shrinkage allowance is consistent with State allowances in many States where they market their products. SIGMA does not believe its members should pay for expansion of tax-paid gallons.

a. How long do you hold gasoline until it is delivered to the purchaser?

Inventory "turns" vary with the level of the gasoline distribution system. At the wholesale level, SIGMA members typically turn their inventories every seven to ten days. Their inventories in outlets at the retail level normally are turned every two to five days.

Chairman PICKLE. Thank you, Mr. Bolch.

Now, Mr. White.

STATEMENT OF RICHARD E. WHITE, VICE PRESIDENT, MARKETING-UNITED STATES, MARATHON PETROLEUM CO.

Mr. WHITE. Thank you, Mr. Chairman.

Chairman PICKLE. Before you testify, one of you gentlemen represents the Society of Independent Gasoline Marketers, and the other the Independent Gasoline Marketers Council. Are you different organizations entirely?

Mr. BLUM. Yes.

Chairman PICKLE. How come you are not working together?

Mr. BLUM. We agree with each other.

Mr. WHITE. I am Richard E. White, vice president, marketing-United States, Marathon Petroleum Co. I appreciate this opportunity to appear before the committee to express Marathon's views on compliance with the Federal excise tax on gasoline. To conserve time, I will summarize my comments. I do ask, however, that my complete statement be entered into the record.

I have with me Duane A. Beamer, assistant treasurer from Marathon Petroleum Co. and he also manages our tax division. Any specific questions on excise tax matters, I may refer to Mr. Beamer.

Based in Findlay, OH, Marathon Petroleum Co., engages in the refining, transportation, and marketing of petroleum and petroleum products. Marathon ranks as the Nation's ninth largest domestic refiner. I am happy to say that the organizations represented by these three gentlemen to my left contain many, many customers of Marathon.

I appear before you today not as a tax expert, but as a petroleum marketer. It is from that perspective that I will attempt to address the issues raised by the committee.

First, we believe evasion of the Federal excise tax on gasoline is a problem. Indeed, evasion of motor fuel taxes—Federal, State, and local—is a serious concern. We believe the vast majority of petroleum marketers are honest and reputable businessmen and women. Nonetheless, we feel the problem of motor fuel tax evasion will continue to grow unless additional measures are implemented in the area of tax collection and enforcement.

Second, we can offer no verifiable estimate of the gasoline tax revenues which are being lost due to tax cheating. Estimates of up to $1 billion have been reported in the media. Maybe that is a plausible estimate—it certainly could be if Federal, State, and local tax losses are combined.

Third, gasoline tax evasion is not just a regional problem isolated to the east coast. We see indications of tax cheating in our Midwestern marketing areas. As an example, improved State gasoline sales tax collection and enforcement efforts in Michigan have resulted in markedly increased State tax revenues, and substantially fewer marketer complaints of tax cheating by competitors.

Fourth, it is not difficult to develop a gasoline tax evasion scheme. There are a number of fairly simple methods by which a marketer can evade the tax collector, if he wants to.

Fifth, there is no way that a reputable gasoline marketer can legitimately compete with a tax cheat. No way. Thus, we believe tightening gasoline tax collection procedures would not only increase Federal revenues, it also would improve the competitive condition of reputable gasoline marketers.

As a general statement, gasoline prices have been declining for some time. And, since the end of last year, prices have dropped dramatically. Conversely, gasoline taxes have been on the rise. As you know, the Federal excise tax on gasoline was more than doubled in 1983 when it was increased from 4 cents to 9 cents per gallon. Over the last 2 years, some 20 States have increased their gasoline taxes. More and more cities and counties are taxing gasoline as well. Combining all of these factors, we have reached the point where taxes—Federal, State and local—represent roughly 25 percent to 40 percent of the retail or pump price of gasoline.

Given all this, one can reach a fairly simple and logical conclusion: there have never been greater financial incentives to cheat on gasoline taxes than there are today.

I mentioned earlier that it was not particularly difficult to evade gasoline taxes. Allow me to offer an example.

Consider a petroleum marketer of medium size who operates a number of retail outlets, say 20 units, and who is a registered producer—that is, authorized to remit his own Federal gasoline tax payments. The marketer correctly reports and remits taxes for sales at 18 of his 20 units. But sales at the remaining two phantom units are never reported.

In the unlikely event that he is audited, he turns over records for his 18 units. To prevent a significant discrepancy between the amount of product which his records indicate he has purchased from his suppliers—most medium to large resellers have multiple suppliers—and that which was sold at retail—since sales at two of the stations were never reported—the marketer either conceals some of his purchase invoices, or alternately creates false billings indicating that he has resold some of his gasoline on a wholesale or bulk basis to other registered producers.

Note, that to discover the deception, an auditor would have to follow the paper trail of invoices upstream to all suppliers and downstream to all bulk customers. Short of doing that, the likelihood of detection is very slim indeed.

Another example deals with the sale of gasohol. As you are aware, gasohol—a blend of 10 percent ethanol and 90 percent gasoline—enjoys a 6-cent Federal subsidy, in that the Federal excise tax on gasohol is only 3 cents per gallon. This tax exemption, which Marathon has opposed for many years, creates ample opportunity for tax cheating. A gasoline marketer can simply remit the Federal excise tax at the reduced gasohol rate—3 cents per gallon—even though he has not blended the required 10 percent ethanol into this gasoline.

I am not implying in any way that most gasohol blenders are cheating on their taxes. We simply believe that there are some who are taking advantage of the gasohol exemption.

Evasion of gasoline taxes is not solely a Federal problem. In fact, some States have already implemented procedures to improve State gasoline tax compliance and to provide for better tracking of gasoline sales. Perhaps one of the most well documented examples is the State of Michigan which implemented a gasoline sales tax prepayment program in January 1984. The legislation implementing the prepayment program also required that a study be conducted and a report made to the legislature on the effectiveness of the program.

That report states, "The prepayment program has proven to be effective in increasing the sales tax collected on gasoline sales." How effective? During the first 5 months of 1984, gasoline sales tax revenues in Michigan rose by over 20 percent. Only a small portion of that increase was attributable to changes in gasoline prices.

Another quote taken from the report to the legislature is also notable. "Surveys show a majority of gasoline distributors approve of the current prepayment system. This system has helped rectify marketing problems affecting the distributors of gasoline." Though the Michigan prepayment system was initially approved for only a 2-year period, the legislature subsequently extended the program on a permanent basis.

Marathon believes the key to improving Federal gasoline tax compliance is to reduce the number of entities authorized to collect and remit the Federal excise tax on gasoline. We do not know the number of producers and importers who are registered with the IRS. However, we are advised that there are between 8,200 and 8,600 individuals and companies who file quarterly Federal excise tax returns for gasoline—form 720.

Presumably, the total number of registered producers and importers is even greater. We believe the concept outlined by the Federal Highway Administration which would, in essence, tax gasoline upon its first sale by a refiner or upon importation, has considerable merit. This program would substantially reduce the number of authorized filers, probably to no more than a few hundred. Essentially all gasoline would flow through the distribution system on a tax-paid basis. The Treasury's ability to audit and enforce excise tax collections would be improved substantially.

Therefore, we encourage the committee to give this approach serious consideration.

We acknowledge that these proposals create valid concerns among refiners and wholesalers alike. Revisions should be implemented in such a way so as not to increase the administrative burden on refiners. Certainly any procedure which would require dual billings by refiners that is one invoice for product and a subsequent invoice for tax would fail to meet this criterion. Further, consideration should be given to a collection allowance, a form of compensation for the administrative costs associated with collecting, reporting, and remitting taxes. Collection allowances are provided by most States.

Wholesalers who are registered producers would face a temporary loss of cash flow in the transition, as mentioned by the gentleman to my left. However, the Michigan experience strongly suggests this difficulty can be resolved. As one possible solution, we suggest that the final semimonthly excise tax payment by producers could be delayed and then satisfied through a series of quarterly installment payments over an extended period. This would eliminate any cash crunch which might be caused by implementation of a precollection program.

Obviously, changes of this magnitude should not be implemented without receiving input from all affected parties. Nevertheless, we are convinced that an equitable program can be implemented within the concept outlined by the Federal Highway Administration. One should not overlook the fact that all reputable marketers would benefit since the program should effectively eliminate Federal gasoline tax cheating.

Motorists also would benefit. The increased revenues collected for the Federal highway trust fund will be used to resurface roads, repair bridges, and accomplish other valuable transportation programs. And, I should point out, these revenues will be realized without an increase in the Federal gasoline tax.

I wish to thank the committee for its attention. I would be happy to attempt to answer any questions you may have.

Thank you.

[The prepared statement follows:]

Statement of

RICHARD E. WHITE
Vice President, Marketing-United States

MARATHON PETROLEUM COMPANY

I am Richard E. White, Vice President, Marketing-United States, Marathon Petroleum Company. I appreciate this opportunity to appear before the Committee to express Marathon's views on compliance with the federal excise tax on gasoline. I compliment the Committee for focusing attention on gasoline tax collection and enforcement efforts, issues of vital concern to all gasoline marketers.

Based in Findlay, Ohio, Marathon Petroleum Company engages in the refining, transportation, and marketing of petroleum and petroleum products. Marathon ranks as the nation's ninth largest domestic refiner. We supply roughly 3,700 Marathon and subsidiary brand retail outlets in the Midwest and Southeast. Also, Marathon is one of the nation's largest suppliers to independent petroleum wholesalers and jobbers who resell our gasoline under their private brands.

I appear before you today not as a tax expert, but as a petroleum marketer. It is from that perspective that I will attempt to address the issues raised by the Committee.

First, we believe evasion of the federal excise tax on gasoline is a problem. Indeed, evasion of motor fuel taxes -- federal, state and local -- is a serious concern. We believe the vast majority of petroleum marketers are honest and reputable businessmen and women. Nonetheless, we feel the problem of motor fuel tax evasion will continue to grow unless additional measures are implemented in the area of tax collection and enforcement.

Second, we can offer no verifiable estimate of the gasoline tax revenues which are being lost due to tax cheating. Estimates of up to $1 billion have been reported in the media. We believe that's a plausible estimate -- certainly so if federal, state and local tax losses are combined.

Third, gasoline tax evasion is not just a regional problem isolated to the East Coast. We see indications of tax cheating in our midwestern marketing areas. As an example, improved state gasoline tax collection and enforcement efforts in Michigan have resulted in markedly increased state gasoline tax revenues, and substantially fewer marketer complaints of tax cheating by competitors.

Fourth, it is not difficult to develop a gasoline tax evasion scheme. There are a number of fairly simple methods by which a marketer can evade the tax collector, with only a very limited chance of detection and prosecution. Later on, I will attempt to provide a few examples.

Fifth, there is no way that a reputable gasoline marketer can legitimately compete with a tax cheat. No way. And, in our opinion, no one is harmed more by tax evasion than the true "small businessman" in the gasoline distribution chain: the service station dealer. Thus, we believe tightening gasoline tax collection procedures would not only increase federal revenues, it would improve the competitive condition of reputable gasoline marketers.

Lastly, Marathon believes the most effective way to eliminate gasoline tax evasion is to substantially reduce the number of entities authorized to collect and remit the federal excise tax. Therefore, we are very supportive of the concept put forward by the Federal Highway Administration which would have most gasoline sales occur on a tax-paid basis. I want to be quick to acknowledge that there would be a few difficulties in making the transition from the current system. Both refiners and wholesalers have expressed legitimate concerns regarding the methods by which such a system might be implemented. However, we are convinced these issues can be addressed and resolved in a fashion that is equitable to all parties. We would certainly encourage the Committee to give this concept serious consideration.

Before I delve deeper into our views on the "hows" and "whys" of tax cheating, I would like to offer some fairly general background information on gasoline marketing and gasoline taxes. Gasoline marketing is a very dynamic and extremely competitive business. Gasoline consumption in the U.S. peaked in 1978, declined through 1982, and has increased only modestly since. The significant decline in the number of service stations over the last decade-and-a-half is well documented.

Gasoline prices have been declining for some time. And, since the end of last year, prices have dropped dramatically. Conversely, gasoline taxes have been on the rise. As you know, the federal excise tax on gasoline was more than doubled in 1983 when it was increased from 4¢ to 9¢ per gallon. Over the last two years, some 20 states have increased their gasoline taxes. More and more cities and counties are taxing gasoline as well. Combining all of these factors, we have reached the point where taxes (federal, state and local) represent roughly 25% to 40% of the retail or "pump" price of gasoline. (Obviously, taxes on gasoline far exceed any profit margin from its sale.)

Given all this, one can reach a fairly simple and logical conclusion: there have never been greater financial incentives to cheat on gasoline taxes than there are today. Additionally, when one marketer cheats, the pressure on his competitors to do likewise becomes intense, perhaps meaning the difference between survival and elimination from the marketplace.

I mentioned earlier that it was not particularly difficult to evade gasoline taxes. Allow me to offer a few examples.

As a first example, consider a petroleum marketer of medium size who operates a number of retail outlets, say 20 units, and who is a registered producer (i.e., authorized to remit his own federal gasoline tax payments). The marketer correctly reports and remits taxes for sales at 18 of his 20 units. But sales at the remaining two "phantom units" are never reported. In the unlikely event that he is audited, he turns over records for his "18" units. To prevent a significant discrepancy between the amount of product which his records indicate he has purchased from his suppliers (most medium to large resellers have multiple suppliers), and that which was sold at retail (since sales at two of the stations were never reported), the marketer either conceals some of his purchase invoices, or alternately creates false billings indicating that he has resold some of his gasoline on a wholesale or "bulk" basis to other registered producers. Note, that to discover the deception, an auditor would have to follow the "paper trail" of invoices upstream to all suppliers and downstream to all bulk customers. Short of doing that, the likelihood of detection is very slim indeed.

Another example of tax evasion, probably on a somewhat larger scale, is what I will call the "hit and skip" wholesaler who sells a large volume of product in a short period of time, but fails to remit any taxes. Paralleling an example which we saw in the Chicago area, a new customer approaches a refiner or other large wholesaler and provides valid tax registration numbers which authorize the supplier to sell on a tax-free basis. The dishonest marketer may have acquired these numbers through falsified applications or by using a valid registration number taken from some other marketer. In this scam, the dishonest marketer purchases a large quantity of gasoline in a fairly short period of time and sells on a tax-collected basis at slightly below market prices. No taxes are ever remitted to the government, however. After a brief period, probably no more than a few months, the marketer shuts down his operation and moves to another locale. By the time the problem is detected, it is likely that the only remnants of the dishonest marketer will be an empty office or an inactive Post Office box.

My final example deals with the sale of gasohol. As you are aware, gasohol -- a blend of 10% ethanol and 90% gasoline -- enjoys a 6¢ federal subsidy, in that the federal excise tax on gasohol is only 3¢ per gallon. This tax exemption, which Marathon has opposed for many years, creates ample opportunity for tax cheating. A gasoline marketer can simply remit the federal excise tax at the reduced gasohol rate (3¢ per gallon) even though he has not blended the required 10% ethanol into his gasoline. If he wishes to be extremely conservative, he will buy an appropriate amount of ethanol to support his claimed gasohol volumes. (For example, if he claims 200,000 gallons of gasohol sales, he will have purchased 20,000 gallons of ethanol.) He may even blend some of the ethanol into his gasoline. But a significant portion of the alcohol is resold to another marketer, preferably in a neighboring state, who will claim the gasohol exemption as well. Easily done; little chance of detection. Now let me emphasize that I do not wish to imply that most gasohol blenders are cheating on their taxes. However, we do believe that the gasohol exemption presents one of the most readily available tax evasion opportunities for small gasoline marketers. (Recent articles in the trade press have reported significant instances of such gasohol tax cheating in Illinois and Colorado.)

Evasion of gasoline taxes is not solely a federal problem. In fact, some states have already implemented procedures to improve state gasoline tax compliance and to provide for better tracking of gasoline sales. Perhaps one of the most well documented examples is the state of Michigan which implemented a gasoline sales tax prepayment program in January 1984. The legislation implementing the prepayment program also required that a study be conducted and a report made to the Legislature on the effectiveness of the program. That report states, "The prepayment program has proven to be effective in increasing the sales tax collected on gasoline sales." How effective? During the first five months of 1984, gasoline sales tax revenues in Michigan rose by over 20%. Only a small portion of that increase was attributable to changes in gasoline prices. Another quote taken from the report to the Legislature is also notable. "Surveys show a majority of gasoline distributors approve of the current prepayment system. This system has helped rectify marketing problems affecting the distributors of gasoline." Though the Michigan prepayment system was initially approved for only a two-year period, the Legislature subsequently extended the program on a permanent basis.

Marathon believes the key to improving federal gasoline tax compliance is to reduce the number of entities authorized to collect and remit the federal excise tax on gasoline. We do not know the number of producers and importers who are registered with the IRS. However, we are advised that there are between 8,200 and 8,600 individuals and companies who file quarterly federal excise tax returns for gasoline (Form 720). Presumably, the total number of registered producers and importers is even greater. We believe the concept outlined by the Federal Highway Administration which would, in essence, tax gasoline upon its first sale by a refiner or upon importation, has considerable merit. This program would substantially reduce the number of authorized filers, probably to no more than a few hundred. Essentially all gasoline would flow through the distribution system on a tax-paid basis. The Treasury's ability to audit and enforce excise tax collections would be improved substantially.

We acknowledge that these proposals create valid concerns among refiners and wholesalers alike. Revisions should be implemented in such a way so as not to increase the administrative burden on refiners. Certainly any procedure which would require "dual billings" by refiners (i.e., one invoice for product and a subsequent invoice for tax) would fail to meet this criteria. Further, consideration should be given to a "collection allowance," a form of compensation for the administrative costs associated with collecting, reporting and remitting taxes. Collection allowances are provided by most states.

Wholesalers who are registered producers would face a temporary loss of cash flow in the transition. However, the Michigan experience strongly suggests this difficulty can be resolved. As one possible solution, we suggest that the final semi-monthly excise tax payment by producers could be delayed and then satisfied through a series of quarterly "installment payments" over an extended period. This would eliminate any "cash crunch" which might be caused by implementation of a precollection program.

Obviously, changes of this magnitude should not be implemented without receiving input from all affected parties. Nevertheless, we are convinced that an equitable program can be implemented within the concept outlined by the Federal Highway Administration. One should not overlook the fact that all reputable marketers will be aided by a program of this nature, in that it should effectively eliminate federal gasoline tax cheating. Motorists also would benefit. The increased revenues collected for the Federal Highway Trust Fund will be used to resurface roads, repair bridges, and accomplish the other valuable transportation programs. And, I should point out, these revenues will be realized without an increase in the federal gasoline tax.

I wish to thank the Committee for its attention. I would be happy to attempt to answer any questions you may have.

(The following was subsequently received:)

Marathon
Petroleum Company

Findlay, Ohio 45840
Telephone 419 422-2121

July 16, 1986

The Honorable J. J. Pickle, Chairman
Subcommittee on Oversight
Committee on Ways and Means
U.S. House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

Re: Compliance with the Federal Excise Tax on Gasoline

As you requested of R. E. White during his appearance before the Oversight Subcommittee yesterday, I am enclosing for the Hearing Record a copy of the report entitled: "Prepayment of Sales Tax on Gasoline, Report to Legislature by [Michigan] Department of Treasury."

The legislation which established the gasoline sales tax precollection program in Michigan (effective January 1, 1984) required that a report be presented to the Legislature by the Department of Treasury on the effectiveness of the program. The report was issued in April 1985. Marathon referenced this report in its statement to the Subcommittee.

Though the Michigan sales tax on gasoline does not completely parallel the federal excise tax, we believe the enclosed report is relevant for a number of reasons.

> First, the precollection program resulted in a significant increase in Michigan's gasoline sales tax revenues. This strongly suggests that taxes on the sale of gasoline were being evaded, and that the precollection program was effective in improving tax compliance.
>
> Second, the report indicates that a majority of gasoline distributors approved of the prepayment system. Retail operators especially were helped.
>
> Third, the report suggests that concerns expressed by gasoline wholesalers and jobbers with the loss of "cash flow" can be resolved. The Michigan solution (arrived at with the cooperation of gasoline refiners, wholesalers and retailers) was to temporarily forestall the final monthly sales tax payment (due

under the prior tax collection procedure), thereby providing marketers with the necessary funds to purchase product on a tax-paid basis. Any cost to the state was quickly recovered through increased sales tax realizations. Marathon believes a similar procedure would resolve wholesaler concerns at the federal level.

Lastly, the precollection program was so successful that the Department of Treasury recommended its extension beyond the two-year "sunset" date (December 31, 1985) stipulated in the Act. The Michigan Legislature subsequently removed the "sunset" date, thereby making the program permanent.

Marathon compliments the Oversight Subcommittee for focusing attention on the problem of gasoline tax evasion. We support the Treasury proposal which would impose the federal excise tax on gasoline at the point of first sale or importation. We are convinced that such a program could be implemented in a manner that is both effective and equitable.

We look forward to working with the Subcommittee and its staff on this issue.

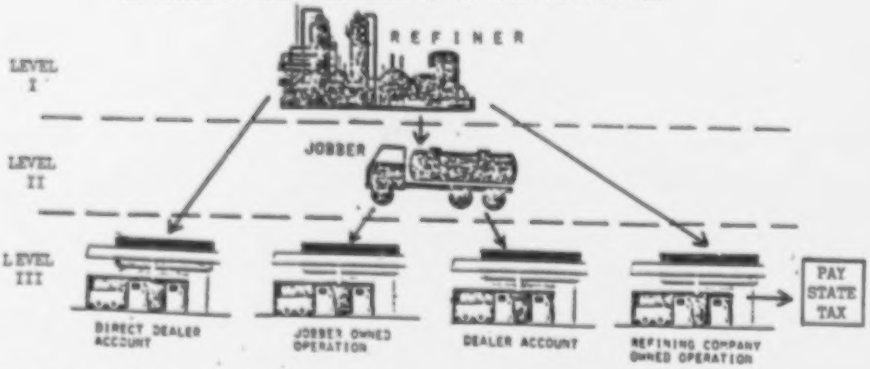
Sincerely,

D. H. Moenter, Manager
Industry & Corporate Affairs

DHM:sdg
ENCLOSURE
cc: Ms. Beth Kuntz

STATE OF MICHIGAN

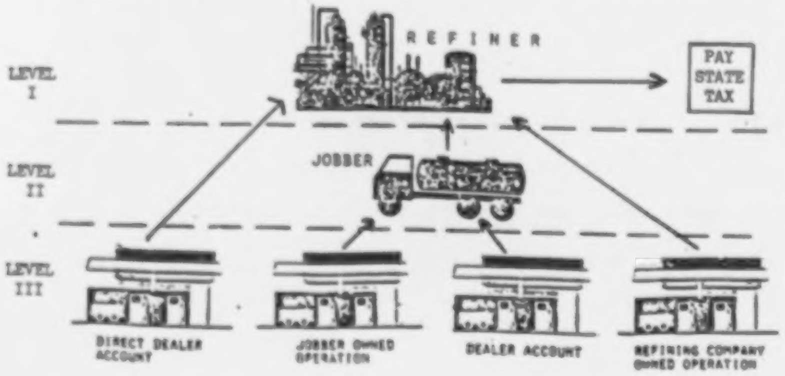
OLD METHOD OF COLLECTING SALES TAX ON GASOLINE PURCHASES


REFINER
LEVEL I
JOBBER
LEVEL II
LEVEL III
PAY STATE TAX
DIRECT DEALER ACCOUNT
JOBBER OWNED OPERATION
DEALER ACCOUNT
REFINING COMPANY OWNED OPERATION

Prior to the implementation of the prepayment program, sales tax on the sale of gasoline was collected at Level III by the retailers and remitted to the state the following month.

PREPAYMENT METHOD OF COLLECTING SALES TAX ON GASOLINE PURCHASES

Under the new prepayment program, sales tax is prepaid at every level to the supplier and the tax is remitted to the state by the refiner. Retailers collect tax from customers to reimburse themselves for prepayments made to their suppliers.


REFINER
PAY STATE TAX
LEVEL I
JOBBER
LEVEL II
LEVEL III
DIRECT DEALER ACCOUNT
JOBBER OWNED OPERATION
DEALER ACCOUNT
REFINING COMPANY OWNED OPERATION

RECOMMENDATION

The Department of Treasury strongly recommends to the House Taxation and Senate Finance Committees that the prepayment of sales tax on the sale of gasoline be continued. HB 4386 deletes the sunset date of December 31, 1985 and we recommend passage.

The Prepayment program was implemented January 1, 1984 and requires the prepayment of sales tax on gasoline by refiners, terminal operators, and importers. The prepayment program has been effective in increasing the sales tax collected on gasoline sales. In 1984 for the period January to June, gasoline sales tax revenue rose from $64,026,543 to $82,527,179, an increase of 23% over the same period in 1983. Sales tax revenues increased $911,610 in 1984 (January-June) compared to that period in 1983 for gasoline sales in Southeastern Michigan.

The cost of implementing the prepayment system has been $90,560.00 to date, less than a penny (.007) per dollar of additional revenue generated. This cost includes data entry costs, systems and programming time, printing of forms and mailing costs.

Surveys show a majority of gasoline distributors approve of the current prepayment system. This system has reduced the turnover of retail operators and helped rectify marketing problems affecting distributors of gasoline. A major marketing problem can occur when some retailers undercut the marked price of gasoline and make a profit through nonpayment of sales tax due. A prepayment program eliminates that opportunity for fraud.

The prepayment program provides the retailer with various benefits. The initial interest free loan equal to the sales tax due for the month of December, 1983 has helped many with cash flow problems. Only those gasoline retailers the state views as an extreme credit risk are required to post bonds of up to $25,000. Prior to the prepayment program, bonds were required from almost every gasoline retailer.

Based on the program results, the Department strongly recommends that the current prepayment program continue.

The Department also evaluated a proposed tracking program to follow the flow of gasoline from the refiner to the retailer to identify underreporting problems. Once identified, the Department would audit to establish tax deficiencies and assess fraud penalties, if applicable. By combining the prepayment program with a tracking program, the State can be certain of receiving the sales tax due from the sale of gasoline, unless there is collusion to defraud.

The tracking system could provide a tool that would enable the Department to keep track of all gasoline sales in this state. However, it is not feasible at this time. This program is costly to implement and maintain. Additional evaluation is needed before a tracking program can be instituted effectively. Any information not submitted would reduce the effectiveness of the tracking system.

The following reports provide additional information.

23% INCREASE IN GASOLINE SALES TAX REVENUE IN 1984

In 1984, total gasoline sales tax revenue increased from $64,026,543 to $82,527,179, a 23% increase over 1983 for the period January to June. For the period January to December, gasoline sales tax revenue increased from $134,870,327 in 1983 to $175,171,887 in 1984. The statewide average price of regular gasoline increased only 2.6% over this period.

During January through May, 1983, miles traveled increased 3.4% over 1982, while reported gallons of gasoline consumed declined 5.6%. A decline in gasoline consumption coupled with an increase in miles traveled is termed "the small car effect," i.e., fuel efficient cars are able to travel more miles on fewer gallons. The "small car effect" does not appear to be present in the comparison of 1984 versus 1983. Miles traveled increased 5.8% in 1984 and reported gallons of gas consumed also increased by 8.2%.

Sources: Monthly Research & Statistical Bulletin issued by the Michigan Department of Treasury; Research Section and Department of Transportation Surveys.

DETROIT FIELD OFFICE STUDY SHOWS 13.4% INCREASE IN SOUTHEASTERN MICHIGAN SALES TAX REVENUES

The Department of Treasury Detroit Field Office compared monthly sales tax payments made by individual gasoline stations for a sample of 351 taxpayers (25% of gasoline stations) in Wayne, Oakland and Macomb counties (Southeastern Michigan). Stations selected had been in business since 1-1-83, and were currently a "going concern." The time period used for comparison was January through June 1983 and 1984. The results were as follows:

Year	Total Sales Tax Paid by Gas Stations (Jan-June)
1983	$6,791,869
1984	$7,703,479

This represents a 13.4% increase in gasoline sales tax revenue reported for these stations in Southeastern Michigan. This means that the State of Michigan has received $911,610 more in sales tax revenue this year compared to last year from a sample of gasoline stations in one area of the State for a 6 month period. This is a significant increase that is most likely a result of implementation of the prepayment of sales tax on gasoline.

As stated in the Lundberg Letter, Vol. XII, No. 12, the prepayment program has resulted in "greatly increased state sales tax revenues" and the program has Michigan "smelling like a rose."

SURVEY OF ATTITUDES OF ALL GASOLINE DISTRIBUTORS TO THE PREPAYMENT PROGRAM

Surveys were sent to a random sample of Refiners, Terminal Operators and Importers, Wholesalers and Retailers of gasoline. The purpose was to determine their attitude regarding the prepayment of sales tax on gasoline. Second mailings were sent three weeks after the initial mailing to help solicit additional responses.

Part I of the Questionaire dealt with the payment program prior to prepayment, the prepayment program itself, chances for error reporting and inventory. Part II concerns attitudes toward a proposed tracking system. Part III solicits information concerning the impact of the program on the taxpayers business.

Results of the survey are as follows:

	"N"	#	#	%
	Population	Surveys sent	Responses	Responses
Refiners	91	91	51	56
Wholesaler	628	50	27	54
Retailer	6114	50	28	56

82% of the Retailers responding felt that the prepayment system should be continued and 71% believe the prepayment has curtailed cheating. Only 19% of the Wholesalers who responded and 37% of the Refiners, Terminal Operators and Importers felt the prepayment program should be continued. The survey indicated 56% of those responding felt positively about the program.

There is, however, a self-selection bias in that responses to questionaires can be misrepresentative of the entire population. Respondents who feel strongly about the program (either positively or negatively) are more likely to respond than those with views in between. Responses did indicate the program has helped retailers with cash flow problems and helped to reduce unfair pricing due to unpaid sales tax. Complaints generally relate to the additional paper work, recordkeeping and forms that have to be filed.

SURVEY OF ALL GASOLINE DISTRIBUTORS ON FILING PREPAYMENT FORMS

The prepayment of sales tax on the purchase of gasoline requires reporting through supplemental forms by licensed dealers of gasoline.

Reports reviewed included the following reports:

1. Refiners, Terminal Operators, & Importers (RTI's) Report of Gasoline Sales Tax Prepayment (form C-3237),
2. Licensed Gasoline Wholesale Distributor Supplemental Sales Tax Report (form C-3239)
3. Gasoline Retailer Supplemental report (form C-3238).

A study of taxpayers current performance in filing these reports showed the following:

PERFORMANCE RESULTS

Dealer	Returns	% Complete
Refiners	145	89%
Wholesalers	195	73%
Retailers	300	68%

Problems or errors on reports resulted from failure to complete the forms. Refiners failed to complete the "Account Number" section of their form. Wholesalers failed to fill in either dollars or gallons or both. Retailers failed to fill in suppliers. Lack of complete information can interrupt tracking of gasoline from the retailer back to the refiner.

TREASURY FIELD PERSONNEL SURVEY ON PREPAYMENT PROGRAM

As part of the evaluation of the prepayment of sales tax on gasoline, Treasury field office personnel were surveyed. The purpose was to ascertain both the attitude of field personnel toward the prepayment system and their perception of taxpayers' attitude.

RESULTS OF FIELD SURVEY

Sixty-six of eighty field personnel (82%) surveyed completed and returned the survey. Eighty-nine percent of the field personnel responding believe the prepayment of sales tax is an effective program. Seventy-four of those responding feel that the tax collection procedure prior to January 1, 1984 was not effective. Field personnel believe the new program is a definite improvement and 86% of those responding do not want to see the tax collection procedure used prior to January 1, 1984 put back into effect.

There is some favorable bias of field personnel toward the prepayment program because it helps work flow but this program also helps the distributor. The prepayment program has improved tax payments from marginal accounts.

MOTOR FUEL FEASIBILITY STUDY OF PROPOSED TRACKING PROGRAM

The Motor Fuel Tax Division reviewed the February 1984 gasoline tax reports submitted by the licensed Michigan Wholesale Distributors of gasoline to determine the feasibility of implementing a system to detect the underpayment or nonpayment of gasoline sales tax required by Act 244 of the Public Acts of 1983. The study revealed the turnover of gasoline to be a major obstacle to implementing an effective tracking program.

The analysis involved 601 of the 630 licensed wholesale distributors who were subject to filing a February 1984 gasoline tax report. The Motor Fuel study does not even address the reporting of gasoline purchases made by retail gasoline station operators, which is also required for a complete tracking system.

The flow of gasoline was followed from 14 major accounts (refineries & terminal operators) and 13 accounts who exclusively import gasoline into the state, down to the taxable level. Four levels were identified through which the gasoline passed before all gallons reached a taxable level.

The information for this analysis came from lines 7, 13, 14, 16, 17, 18, and 20 of the February gasoline tax reports and the following supporting schedules:

1. Schedule A - Summarizes the gasoline imported into or purchased in Michigan upon which the state road use tax has not peen paid.
2. Schedule C - Gasoline distributed through marine terminals and pipeline terminal facilities.
3. Schedule E-2 - Summarizes sales of gasoline to other licensed wholesale distributors for deliveries in the State of Michigan upon which tax was not collected.

4. Schedule E-1, J & K - Which summarize exempt sales to the U.S. Government, the State of Michigan, and/or local units of Government, other nontaxable purposes, and exports.

MOTOR FUEL FINDINGS

There were 298,919,666 gallons of gasoline imported into Michigan for February, by these accounts. Tax-free transfers of this same gasoline between the first level accounts involved 124,380,158 gallons and resulted in a total of 423,302,430 gallons actually reported by these accounts. Of the 298,919,666 gallons imported into Michigan during February 1984, 124,380,158 gallons were transferred among the 1st level accounts resulting in 423,302,430 gallons reported by all 1st level accounts.

It must be noted that the law allows certain tax-free transfers of gasoline between licensed wholesale distributors and that such transactions are quite common. These transfers are reported by the sellers on the E-2 schedules and by the purchasers on their schedule A's. The study shows that transfers occured at all levels.

The second level identified 432 wholesale distributors. These accounts were all supplied by the 14 major accounts and 13 importers identified in the 1st level. The 3rd level identified 100 wholesale distributors, who were supplied by the 2nd level wholesale distributors.

A portion of the reported E-2 schedule gallons becomes the starting point of the 4th level of the analysis. The study stops at this point because of the small number of gallons involved.

MOTOR FUEL FEASIBILITY STUDY RESULTS

There are limitations and problems regarding the survey results and they are cited here because their significance must be considered when contemplating the implementation of a tracking system. Problems confronted were:

I. Volume of Transactions - A complete tracking system requires recording every gasoline transaction. Our analysis shows the number of transactions at each level as follows: (using 7,000 gallons per transaction, which is industry average per load)

	Transactions
1st Level	120,943
2nd Level	53,057
3rd Level	3,580
4th Level	116
(Review beyond Schedule A is not done at this level)	
TOTAL FEBRUARY TRANSACTIONS	177,696

The review of required information for each transaction would involve a minimun of 57 key strokes by the data coding operator.

Total Keystrokes for the February transactions:

177,696 x 57 = 10,128,672

Average keystrokes per hour = 10,500
(by data coding operator)

Total hours required per month = 965 x 16.39 (Data entry costs per hour) = $15,816.35 to process returns each month. Data entry capacity is not currently available even if funding were.

During 1983, 3.5 billion taxable gallons of gasoline were sold in Michigan.

II. **Tax free transfers of gasoline between levels, and transfers of gasoline between accounts within each level.** This analysis revealed that the total gallons transferred (E-2 schedules) and the required report of receipt of these gallons on Schedule A involved 931,940,747 gallons. This turnover of the base *307,049,768 gallons represents the biggest obstacle to a tracking system. Attempting to follow the flow of gasoline through numerous wholesale distributors, before reaching its final transaction is extremely difficult.

*298,919,666 gallons of new gas identified at the 1st level plus 8,130,102 gallons of new gas identified at the 2nd level.

III. **Incomplete or incorrect information (errors and omissions).

At the present time, Motor Fuel internal auditors found that 35% of the gasoline tax reports filed have incomplete or incorrect information that must be corrected through correspondence with the reporting gasoline wholesale distributors. These errors may have a major impact on the tracking system.

IV. **Delinquent Accounts - Licensed wholesale distributors who are delinquent in filing their gasoline tax reports will leave gaps in the tracking system. Delinquent accounts who would appear in the 1st or 2nd level of the flow of gasoline exacerbates the delinquency problem.

**Note: The significance of these problems are showing up in our analysis. Our numbers do not agree because of various reporting errors, and the delinquency problem.

V. **Information required for a complete tracking system is not now being reported by the licensed wholesale distributor.** Sales to retail gasoline dealers is the ultimate goal of the tracking system. Ending inventories at the wholesale level will become sales to retail dealers in the following month. Sales to retail gasoline dealers and wholesale distributors ending inventories are not being reported. In addition, there are jobbers who buy and sell gasoline in large quantities who are not licensed wholesale distributors. These jobbers will be required to report their transactions in some fashion.

J.J. PICKLE, TEXAS, CHAIRMAN
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COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES
WASHINGTON, DC 20515

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A.L. SINGLETON, MINORITY CHIEF OF STAFF

BETH KUNTZ, SUBCOMMITTEE STAFF DIRECTOR

July 22, 1986

Mr. Richard E. White
Vice President-Marketing
Marathon Petroleum Company
Finley, Ohio 45840

Dear Mr. White:

Enclosed are additional questions the answers to which will provide a more complete record for the hearing on gasoline excise tax evasion that was held by the Subcommittee on Oversight on July 15, 1986.

I hope you will be able to expeditiously respond to the enclosed questions, as the hearing record will be going to the printer on September 12, 1986.

If you have any questions, please contact Beth Kuntz, Staff Director, at 225-5522. Thank you for your cooperation on this matter.

Sincerely,

J. J. Pickle, Chairman
Subcommittee on Oversight

JJP/tmk

Enclosure

QUESTIONS FOR MARATHON PETROLEUM COMPANY

1. What specific information do you have with regard to the extent and geographic location of gasoline excise tax evasion?

   a. What size and type of firms are involved?

2. What further steps will you, as an industry, take to eliminate or reduce gasoline excise tax noncompliance?

3. We also hear about gasoline bootlegging where gasoline is imported into the U.S. or moved across state lines without notice. Among other things, bootlegging provides the system with untaxed gasoline which competes with honest business operations.

   a. Who knows (or should know) what gasoline enters terminals undercover or at night?

   b. How big do you suspect bootlegging is in comparison to other gasoline excise tax evasion schemes?

4. One way to address the noncompliance problem could be through administrative changes and additional enforcement efforts by federal agencies (IRS, Justice, FBI).

   a. What are your views on what further steps could be taken administratively to deal with the gasoline excise tax evasion problem? Federal level? State level?

   b. Could the U.S. Customs Service, FBI, or Justice Department do more by way of enforcement? If so, where and what?

5. What could be done to enhance information sharing with the States?

6. With regard to proposals for earlier collections of gasoline excise taxes, what level of shrinkage allowance do states allow? Is 1.5% consistent with state allowances? What about the expansion of tax-paid gasoline? Should adjustments be made here as well?

   a. How long do you hold gasoline until it is delivered to the purchaser?

Findlay, Ohio 45840
Telephone 419/422-2121

September 9, 1986

The Honorable J. J. Pickle, Chairman
Subcommittee on Oversight
Committee on Ways and Means
U.S. House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

In response to your July 22 letter addressed to R. E. White, enclosed please find Marathon's responses to the additional questions posed by the Subcommittee with respect to gasoline excise tax evasion.

Should you or your staff have additional questions, please feel free to contact me.

Sincerely,

D. H. Moenter, Manager
Industry & Corporate Affairs

DHM:sdg
ENCLOSURE

QUESTIONS FOR MARATHON PETROLEUM COMPANY

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    a. What are your views on what further steps could be taken administratively to deal with the gasoline excise tax evasion problem? Federal level? State level?

    b. Could the U.S. Customs Service, FBI, or Justice Department do more by way of enforcement? If so, where and what?

5. What could be done to enhance information sharing with the States?

6. With regard to proposals for earlier collections of gasoline excise taxes, what level of shrinkage allowance do states allow? Is 1.5% consistent with state allowances? What about the expansion of tax-paid gasoline? Should adjustments be made here as well?

    a. How long do you hold gasoline until it is delivered to the purchaser?

RESPONSES OF MARATHON PETROLEUM COMPANY
TO QUESTIONS POSED BY THE SUBCOMMITTEE ON OVERSIGHT

Response to Question #1:

Marathon has little in the way of "specific information" on the extent of gasoline excise tax evasion. Obviously, we have neither the resources nor the authority to audit customer compliance with federal, state and local taxes which apply to gasoline sales. However, we can offer some general observations that may be germane.

Evasion of gasoline taxes is not a problem isolated to the East Coast of the United States. As was mentioned in our testimony, the State of Michigan instituted a gasoline sales tax precollection program at the beginning of 1985 in an effort to combat alleged tax cheating. During the first six months of 1985, Michigan's gasoline sales tax revenues increased by over 20%, giving witness to the extent of tax cheating. Interestingly, California has just initiated a similar program. Experts in California have estimated that the state is losing at least $150 million per year of gasoline sales tax revenues due to tax cheating. At the Oversight hearing, state officials from both New York and Florida testified to the revenue gains they experienced by tightening state gasoline tax collection procedures. While there is not a direct parallel between state sales taxes on gasoline and the federal excise tax, the state experiences strongly suggest tax evasion is a serious problem that affects all areas of the country.

With respect to the size and types of firms involved in tax evasion, we can offer a few generalized comments. We are aware of no refiners who have been found to be involved in schemes to evade the federal excise tax on gasoline. By observation, we note that many of the gasoline marketers who have been indicted for gasoline tax evasion are of medium size and frequently operate in multiple states. We fear that competitive pressures are prompting some marketers to evade gasoline taxes either by underreporting gasoline sales or by reporting excessive amounts of "gasohol" sales in an effort to improve their margins. Perhaps the class of marketer least likely to be involved in a tax evasion scheme, but who most directly suffers its consequences, is the individual service station dealer. Since dealers generally must buy gasoline on a tax-paid basis, they have little opportunity to evade the gasoline excise tax. Thus, we are convinced that efforts to improve excise tax compliance will be a competitive "plus" for service station operators.

Response to Question #2:

A refiner's primary responsibility with respect to the federal excise tax on gasoline is to maintain accurate records on gasoline sales and to fully comply with federal excise tax collection and remittance procedures. Beyond seeking proper documentation from tax licensees and other tax-exempt purchasers prior to making a tax-exempt sale, there is little additional effort which refiners can legitimately undertake to insure that their customers are in compliance with the federal excise tax. As a refiner, we have neither the responsibility nor the authority to audit customer compliance with the federal excise tax.

With respect to possible changes in gasoline excise tax collection procedures, it is entirely possible that refiners may be required to provide additional detail to the Treasury on gasoline production and sales. While we stand ready to cooperate with these efforts, we are hopeful that any new procedures will not significantly increase the administrative or financial burden on refiners or any other class of trade within the gasoline distribution system.

Response to Question #3:

Gasoline is usually shipped to a refined products terminal via common carrier pipeline or tanker or barge. Such "bulk shipments" are fairly easily traced from refinery or port of entry to the terminal. It is our belief that most tax evasion occurs beyond the terminal rack, after the gasoline has been loaded into trucks for further delivery or sale. Thus, we believe that the recently-developed proposal which would tax gasoline at the terminal truck loading rack would essentially eliminate evasion of the federal excise tax on gasoline.

We believe "bootlegging" is a far more serious concern with respect to the evasion of state and local gasoline taxes than the federal excise tax. There are practically no restrictions on the transporting of gasoline across state and local jurisdictional borders. Bootlegging is further simplified by the fact that many neighboring states do not have a common reporting methodology by which they can share data on gasoline deliveries and sales.

Response to Question #4:

Obviously, additional enforcement efforts by federal agencies should increase compliance with the federal excise tax on gasoline. However, we do not believe that additional enforcement efforts alone can dramatically reduce the amount of tax evasion. In our view, to effectively address the federal excise tax evasion problem, it will be necessary to significantly reduce the number of entities who are authorized to collect and remit the excise tax. As was noted at the Oversight hearing, even a medium-size jobber can have literally dozens of suppliers and hundreds of customers, in addition to his own retail outlets. Given this, and the fact that currently there are over 8,000 tax licensees, it is impossible to conduct meaningful audits on a broad scale.

One change which could be made to significantly increase compliance with the federal excise tax is the elimination of tax-exempt sales. Such sales create ample opportunity for tax evasion. Instead, a system should be implemented where entities who are legitimately tax-exempt are required to purchase gasoline tax-paid and then apply to the federal government for a refund of the excise tax. This refund procedure should apply to the 6¢/gallon "gasohol exemption" as well. While this proposal would require the Treasury to develop an expedited refund system, it would allow for eventual verification and auditing of tax-exempt purchases.

Response to Question #5:

Enhanced information sharing among the states is critical to improving state and local gasoline tax compliance. Given the number of transactions that occur in gasoline marketing each day, it is essential that any shared information be computer accessible. Interestingly, the State of Florida recently became the first state to require that gasoline sales data be reported on computer magnetic tape. In Marathon's view, it is essential that the states develop a common reporting scheme, not only to ease the administrative burden on refiners and gasoline marketers, but also to allow the states to share data on gasoline sales. Such sharing of information in a computer-readable format would allow the states to significantly reduce the bootlegging which was referenced earlier. Ideally, a common reporting system could be developed which would meet the needs of federal, state and local taxing authorities.

Response to Question #6:

The combination of collection and/or shrinkage allowances provided by the states range up to 3%. A general allowance of 1.5% would be representative.

There is no "standard" period of time from the point at which gasoline is manufactured until it is delivered to a retail outlet or to an end-user. Delivery times vary dramatically from refiner to refiner, and across various geographic regions of the country. As an example, some of the gasoline that Marathon sells in the Great Lakes area, and practically all of the gasoline sold out of our terminals in the mid-Atlantic states, is manufactured at refineries located in Texas and Louisiana. The pipeline transit times for such deliveries can vary from 10 days to 3 weeks. When seasonal inventory variations are considered, periods of a month or more can elapse from gasoline manufacture to its sale. Given these considerations, we find it impossible to identify a truly representative time period.

* * *

Submitted: September 9, 1986

Chairman PICKLE. Mr. Schulze.

Mr. SCHULZE. Thank you, Mr. White.

I would like to thank the panel for their very interesting testimony.

Mr. Potter, I appreciate the vehemence of your testimony. As a former businessman, and a former small businessman, I knew generally what was going on in my industry.

Are you telling me that this evasion is not going on, that it is not widespread, or just not widespread in your area? Do you think you have your finger on the pulse of the industry across the country in your role as president, Mr. Potter? Do you spend a lot of time traveling, talking to others? Please give me a little more substance, if you would.

Mr. POTTER. Mr. Congressman, to answer your last question first, yes; I do travel quite a bit. I have traveled over most parts of the United States. I have not been in Florida. I have not been in New York. I have been in quite a few of the other States.

I do not find that the question of tax evasion, Federal tax evasion, or State excise tax evasion, is a problem in those areas.

I am not naive enough to believe that it may be going on, as you have heard testimony to today, in those areas that were mentioned.

I was shocked to hear that my State that I am quite familiar with was, that the tax, I think the statement was that tax, Federal excise tax evasion was rampant in North Carolina.

That makes it hard for me to believe.

Sometimes people draw a conclusion that there is tax cheating going on when they ride by one station and see the price on the street at several cents or whatever below the other, when really that marketer at the station with the lower price may have a lower buying price. He may not be as implied a tax cheater. I really cannot believe that in the statistics, in my prepared statement, there is a table, table 1, that shows that compared with the EIA figures, the Department of Energy, that the tax collection is running in excess of 97 percent. I do not have that right before me. I could look and seek what the exact figure is, 97.2 percent in 1984 and 7.9 percent tax collection in 1985, so I cannot believe from the figures that come out of the Energy Department of the gallons produced and imported compared with the tax collection, that there is the extent of the tax evasion that has been implied today.

Mr. SCHULZE. Is your company integrated?

Mr. POTTER. My company, sir?

Mr. SCHULZE. Yes.

Mr. POTTER. I am a small marketer in eastern North Carolina. We sell to commercial contracts, and we sell to marinas, and we operate retail outlets ourselves.

Mr. SCHULZE. You are not aware of any drop off in business from bootleggers or others who are cutting into your market?

Mr. POTTER. No, sir, we have enjoyed an increase in business versus this year and last year versus the year before.

Mr. SCHULZE. Statistically as you look at your figures, you see no evidence of manipulation in the market?

Mr. POTTER. I would not say absolutely no evidence. I would say there could be possibly on a smaller scale than what some of the figures have been implied. From this table 1, it would show you that it is much smaller than has been implied today.

Mr. SCHULZE. Do you have an agreement with your retail outlets requiring them to buy solely from you?

Mr. POTTER. I operate the outlets myself so they better buy from me.

Mr. SCHULZE. But if the operator was purchasing any amount of gasoline elsewhere, you would be aware of it immediately?

Mr. POTTER. Yes, sir, because all of our stations, one of the things that concerns me about taking the tax backup is the fact that, on meter variations, we sell gasoline through all of our contracts and we collect the money from meter sales so that is one of the reasons why we feel that we would need a shipping charge or a handling allowance, so be it, if we go on to paying Federal excise tax and purchases rather than sales.

Mr. SCHULZE. Do you have any recommendations in the area of diesel fuel? It seems to me that diesel fuel is going to present a larger problem because of the similarities with home heating fuel. I wondered whether any of you have any recommendations in that area?

Mr. POTTER. Yes, sir, we strongly recommend that the Congress adopt Chairman Pickle's amendment to the tax version of the tax reform bill because we feel that is where a lot of the diesel tax evasion is occurring at the dealer level, not intentionally.

A lot of dealers that are collecting and remitting are—several things. They could be unaware that diesel tax has increased to a small, much smaller businessman than I am, like a dealer, he cannot understand that the tax on diesel fuel is not being collected like it is on his gasoline, and so I think that if this amendment were adopted, this would alleviate a lot of the diesel tax that is not being paid at this point.

Mr. SCHULZE. Does anyone else have any thoughts?

If not, I thank the panel, and I thank you, Mr. Chairman.

Chairman PICKLE. Thank you, Mr. Schulze.

I think you gentlemen have given us strong testimony that in a way is contrary to the general tenor and theme we have been hearing from the other witnesses during most of the morning.

We must admit that there is considerable evasion, and that apparently, it is in every State. Mr. Bolch, you may be surprised that it is happening in North Carolina, and I was surprised that it is happening to any degree in Texas.

I recognize that indications of evasion came first today from the unknown witness this morning. I don't know how much validity to put in that, except I don't think he would be making that statement if evasion didn't exist, so I accept the fact in my State it is taking place, and I am certain it is a national problem. Something has to be done about it.

As we look for some kinds of answers, we all ought to recognize first, it is a matter of enforcement. We have not been given sufficient support by the IRS, or the Justice Department, and we have either looked the other way or we are just hoping it wasn't that bad a problem.

Even when we have testimony that some of you have gone to the Justice Department, as you did, Mr. Blum, and they still didn't act.

What gives? It almost makes you want to suspect your own government, and there has to be a better answer to the problem. We are trying to find that out.

If changes were made and the tax were put at the refiner level, at the first output, why would that put you at a disadvantage, at an economic disadvantage, to the refiners, Mr. Potter?

Mr. **Potter**. Yes, sir. Mr. Chairman, if the refiner did not have to pay the tax until he sold it, take tax-exempt like local governments, for instance, he would have the opportunity to sell then without collecting the tax, because they are a tax-exempt customer, where if I have to pay on purchasers, when I sell to that customer, I have either, in most cases, if I wanted to get the business, I would have to sell them X, the Federal excise tax, so I have paid it, but I have sold it without the tax, and now I have to go through some process of getting my money back.

This again would open the doors for tax evasion. I could claim sales to governments or local municipalities or other tax-exempt customers, and unless the enforcement an auditing process was better than what it is now, that would never be audited, and I would just put the tax in my pocket.

We feel it is very important that the IRS and the Justice Department become more highly visible with their audits. I don't know of anyone in this packed room, if I could have said that earlier, in this packed room this morning that doesn't fear that phone call or that letter that comes from the IRS, that says, "We are coming over to audit your income tax return." They shake in their boots when they hear that.

If Justice and the IRS were more visible in this area of excise taxes, that would deter a lot. It has been pointed out how easy it is to get a producer's license. You write in to the IRS, to the district office and get a producer's license. We feel like it should be a harder process than that. We feel that they should have to go and make a commission.

Talking about moving the tax up to the refiner, I have a letter that I would like to enter as part of my testimony here, Mr. Chairman, if that is permissible, from our member association in New York, the Empire State Petroleum Association, and they say that by moving the taxes, New York has taken collection, and I will read just one sentence.

"Whatever success there has been in New York State, and we have yet to address diesel, Indians and gross receipt tax evasion, it has been one at great cost to small petroleum marketers."

They have lost a lot of their members who have either sold out or gone out of business because of the economic burden that this has put on them.

Chairman **Pickle**. I will ask that that entire letter be made a part of the record. I am glad you mentioned it.

[The letter follows:]

ESPA
EMPIRE STATE PETROLEUM ASSOCIATION, INC.
8 WESTCHESTER PLAZA • ELMSFORD, N.Y. 10523 • 914-592-8810

July 9, 1986

Mr. Thomas Potter,
President
Petroleum Marketers Association of America
1120 Vermont Avenue NW
Washington, DC 20005

Dear Tom,

We understand you are testifying in hearings next week on compliance with the Federal Excise Tax on the sale of gasoline. Perhaps a brief outline of our experience in New York State will be helpful in avoiding some of the harmful impacts on small independent oil marketers.

Licensed oil distributors were the first victims of motor fuel tax evasion in New York State. Marginal operating profits made them extremely vulnerable to unscrupulous competitors evading any one of the various New York State motor fuel taxes. Initial approaches to the State Tax Department in 1980 for greater enforcement were fruitless. And, in 1981 appeals were made to the Governor and opposing party leaders to consolidate the petroleum taxes in a more rational structure.

Instead, a Gross Receipts Tax was imposed on all petroleum importers for the privilege of doing business in New York State. But, Federal agencies would not share information on petroleum shipments, and New York State had no way to determine beginning petroleum inventories. This was an open invitation to gasoline bootleggers, and soon weaknesses in the tax collection system became widely apparent. Subsequently, with a change of Administrations, a new Tax Commissioner answered our appeal to reform the system. With industry's total support, the Tax Department achieved a higher level of knowledge, competency, and coordination. Only enforcement continue to lag.

Apparently due to manpower and Budget restraints, Tax officials decided to defer action on the Gross Recepits Tax on petroleum imports, to ignore blatant petroleum tax evasion by Indian entrepreneurs, and to put aside consideration of diesel tax evasion. Unfortunately, these glaring tax loopholes are still with us. Officials also decided to reduce the number of licensed distributors to ease the Tax Department's administrative workload - a questionable public policy at best.

Applying gasoline taxes to the first in-state sale was proposed by major refiners and accepted by the Tax Department. Only our last minute appeal to the Legislature got the measure changed to a First Import basis to correct some of the obvious inequities.

In the year since the First Import Tax was enacted, it has been projected that approximately half of the evaded petroleum tax will be recovered. During the year an Industry/Government Advisory Tax Council, which was mandated by the Legislature, has played the key role in guiding implementation of the new Law. In addition, the Tax Department now acknowledges that the First Import Law did not stop petroleum bootlegging, and a series of additional measures have been agreed upon.

Whatever success there has been in New York State - and we have yet to address diesel, Indians, and Gross Receipt Tax evasion - it has been won at great cost to small petroleum marketers. Even through they were the original petitioners for increased enforcement, they are frequently maligned and treated as perpetrators. Bonding has become unaffordable - if available, and paperwork for dozens of detailed monthly tax reports is a costly burden. The dramatic reduction in licensed operators will result in lessened competition. And, the elimination of traditional cash-flow is reducing credit lines by suppliers and downward revisions in bank loan limits. These are especially serious threats to small businesses.

Therefore, we suggest that whatever strategy is eventually employed to eliminate petroleum tax evasion, you make every effort to educate the Legislators on the need for maintaining a level playing field. Too often Tax officials, once motivated to action, do not feel any responsibility for industry dislocation. This is why many small oil marketers have come to fear being put out of business by well intentioned tax regulators almost as much as by the anti-competitive behavior of tax evaders.

Cordially,

Bob

Robert D. Lynch
Executive Vice President

RDL/acw

Mr. **Potter**. Thank you, Mr. Chairman.

Chairman **Pickle**. We agree, there must be better enforcement, with more audits. There must be more review of the forms that are submitted to get your license to become a registered producer. We also have to recognize that the least number of steps in which you could have tax-exempt status probably would be desirable.

If you had 20 different levels that your tax exemption would flow through, that is an invitation for problems, for evasion.

My question would be to you, in order to try to limit the point of taxation to the refinery, at the first sale point, would it be workable if we had a first sale point of collection, but allow for a delay of 14 days at some point, so that one unit wouldn't get an advantage over another.

That is, a refiner wouldn't get an advantage over a jobber. Could you have a float period in there that would be workable?

Mr. **Bolch**. Mr. Chairman, part of the problem with the existing tax, if you exclude some but allow others, is that the people that can pay it can choose when they want to pay it. OK, it is one the first sale, whenever that first sale is, not when it comes out of the refinery gate, or when it is blended or imported or whatever, or at the retail sale.

It is at the first sale, and that allows whoever has that status of producer to have an advantage in terms of delaying the payment of the tax, and the use of those funds over everyone else who doesn't have that status.

That is the biggest problem that you have with eliminating some people from that definition. However, whoever gets eliminated automatically has a disadvantage. The first sale to a nonproducer.

Chairman **Pickle**. I find it a little bit confusing, in a way, Mr. Potter says there is really not a problem here. One of you independent gasoline marketers says it is not a problem, the other says it is a huge problem, and the refiners know about it.

Mr. **Bolch**. There is clearly a problem, but the problem is pretty much limited geographically to certain parts of the country. It is not in the part of the country where I live. I live in Atlanta, and we market from Texas to Maryland, all through the entire South. I don't market in Miami and New York, and it seems that that is where organized crime has gotten involved in it.

The enforcement of the IRS is extremely lax.

Chairman **Pickle**. I think we would all agree that more must be done in that area.

Mr. White, you were trying to make a statement, were you?

Mr. **White**. Mr. Chairman, a couple of points as a refiner, I would like to make. I certainly agree with these gentlemen who have testified here, a refiner should not have an advantage.

In the State of Michigan, and we are a large supplier to independents and jobbers in the State of Michigan, and we worked very closely with the State to try to develop a program whereby, in fact, the marketers were not hurt, and yet the State of Michigan could achieve a better tax revenue base.

We developed a program there whereby the remittance of the tax is delayed by a month, in the case of the Michigan State sales tax. This was put into effect on a 2-year temporary basis. It was so successful that it has now been placed on a permanent basis, and the marketers, dealers, jobbers in the State of Michigan, as well as the suppliers, are very happy with that kind of a program.

Chairman PICKLE. That is a 30-day delay?

Mr. WHITE. That is correct. That was a very effective means to alleviate cash-flow problems. We all agree that enforcement needs to be strengthened, no question about that.

We must be aware, we are aware, because many of our customers complain about their competitors in the marketplace evading taxes. That is why we know that there is a fair amount of that going on.

We want to make sure that it is a fair market for all of us to compete in, and that is why we have to get the tax evaders out. And by working together, as we did in the State of Michigan, we can come up with a viable solution.

Chairman PICKLE. Mr. Blum, I believe your statement was probably as strong as any, which mirrored your frustration at being almost ignored when you made this information available to the authorities, and they did not respond to it.

You went to a Mr. John Keeney, Deputy Assistant Attorney General, Justice Department. Did anything ever come of the information you gave to him?

Mr. BLUM. Not to my knowledge. I talked to him last December, following conversations earlier with the New York State attorney general, and earlier than that, about the same time, with the Federal Trade Commission. I had been hearing that an investigation was underway, but nothing came of it, and I went to Mr. Keeney.

Chairman PICKLE. Make a big show, but nothing after the big boys.

Mr. BLUM. That is the proposition that was put on the table. I would like to comment about changing the level of collection. That won't affect the problem as we are seeing it, because the simplest solution of all for people who have been doing what they have been doing is to get around documenting the gasoline at all.

If you import blend stocks and blend gasoline yourself, there may not be the kind of paper record that permits anyone to say there has never been gasoline before. As has been happening apparently on Long Island as gasoline is delivered to retail stations in the dark of night, that gasoline may never have been known to have existed.

The business of blending gasoline in locations other than a refinery is an important, indeed essential part of the domestic gasoline supply. An awful lot of people do it, particularly in the ports where they bring in below-grade foreign gasoline, blend it with various blend stocks and make it part of the available domestic supply.

That is a perfectly legitimate, appropriate business. If somebody wants to cheat, if there is no law enforcement, they are going to do it. My point here is, that when I can talk to people in my industry and they tell me things like this, I have been in the business 20 years and nobody has ever looked at my excise tax return.

When they can tell me that they will sit with their computer terminal where they are looking at available suppliers and suddenly, three companies nobody has ever heard of turn up in a market supplying gasoline 3 cents lower than everybody else, and one guy walked into the FBI, and they said we don't know what we are supposed to do, or why we should investigate.

Before anybody fiddles with the level of collection, or the Government people here blew the collection process totally, who have been on the table and known about it for 4, 5 years, before they get away with walking in and telling you that the problem ought to be put on our back, they ought to be held accountable and somebody ought to find out what they have been doing.

Chairman PICKLE. Maybe we have all got to share in this responsibility, the Treasury, IRS, perhaps the dealers, the refiners, because we obviously have a national crisis here in this field. Something should be done about it, and so I would agree that we have to have more accountability.

I don't think this committee will look lightly on these things. The question is, can we simplify the procedure any and still not give an advantage to any one level of collection, such as the refiners?

I don't know that we can do that, but we are trying to see what some of our possibilities are. We can't afford to lose this kind of revenue for the Highway Department.

Besides, it is against the law. We have got to look at the broad picture and see the points that we have made today. We are going to follow through and have another hearing on this question.

I think we have perhaps opened a national debate on a problem that exists with your dealers, your operators and with the public. Somehow, we have got to focus in on this problem and see what we can do about it.

This committee is not not convened for the purpose of advancing some legislation. We are simply trying to understand the problem. What is the extent of the problem out there? Is it regional or local? Is it the result of small-time individuals? Is it being violated by the big boys?

If so, are we overlooking them? Is there any involvement by the refiners, and I think we have got to look at that closer, because they have overlooked some of this.

There is enough concern at every level, that we have got to do something about it. Mr. Schulze, do you have any other questions?

Mr. SCHULZE. No, Mr. Chairman, I do not. Thank you very much.

Chairman PICKLE. Well, I make this observation, if we make it harder for a producer to register for tax-free sales, as summarily done now, should we also have better bonding procedures? Would that help?

Mr. BLUM. It would have helped enormously in New York. You would find out pretty quickly that the corporation was registered to a vacant lot, and was put together by three guys who had never seen a gasoline pump.

Chairman PICKLE. Do you all agree bonding requirements should be stiffer? Before 1965, the law required a producer to post a bond to assure he would be paying these taxes. Would you go back to that procedure?

Mr. POTTER. Mr. Chairman, let me quote another sentence from the letter in New York that I alluded to earlier. Bonding has become unaffordable if available. A few months ago, I sat before this committee and testified about insurance and the problem we are having with insurance. I really don't know what the insurance industry would do about bonding, about issuing bonds at this point, so it would be hard to say whether bonding would be a solution or not.

It may be a detriment to us, to change that requirement.

Mr. BOLCH. Mr. Chairman, the enforcement by the Internal Revenue Service, there may very well be very legitimate, above-board businesses out there that are not calculating their taxes correctly, and making mistakes.

Well, somebody needs to be finding out that and assessing them the taxes that are not being paid. If the IRS is not out there assessing the taxes, perhaps some of the taxes are slipping through by legitimate businesses that are not paying their taxes because they've got some clerk that does not know how to calculate the tax correctly.

So, in any event, we have to have better enforcement of the excise tax laws. It does not matter who pays it. If you move it to Marathon, somebody needs to audit Marathon, and I am not accusing Marathon, but some clerk in Marathon may make a mistake.

Chairman PICKLE. You mean Marathon and others?

Mr. BOLCH. Sure, it doesn't matter who is paying the taxes, somebody needs to check on them.

Chairman PICKLE. I would agree with that, and I am sure that the administration agrees with it. We are disappointed in the fact that we have not gotten more concrete information from both Treasury and the Internal Revenue Service about what is happening out there, but we will pursue that.

We are going to try to get more information, and this is one of the first of a series of hearings, and your testimony has been very helpful to us. Let me assure you we are not trying to rush out here and put somebody out of business. We are trying to see the scope of this problem. Are producers avoiding taxes? If so, we ought to enforce the law, prosecute them, put them behind bars, any of those people violating the laws.

If we did that, that would probably straighten things out.

Mr. BOLCH. I wasn't trying to implicate Marathon, because they would be the last people to do something like that. We all need to be checked. That is my point.

Chairman PICKLE. I thank you gentlemen very much. Your testimony has been listened to, and we will keep in touch.

This concludes the hearing today, and the committee will stand adjourned.

[Whereupon, at 2:35 p.m., the hearing was adjourned.]

[The following material was submitted for the record:]

SUBMISSIONS FOR THE RECORD

AMERICAN ASSOCIATION OF STATE HIGHWAY
AND TRANSPORTATION OFFICIALS

THOMAS D. LARSON, President
Secretary
Pennsylvania Department
of Transportation

FRANCIS B. FRANCOIS
Executive Director

RECEIVED
JUL 14 1986
Ways and Means
Subcommittee on Oversight

July 11, 1986

The Honorable J. J. Pickle, Chairman
Subcommittee on Oversight
Committee on Ways and Means
1101 Longworth House Office Building
Washington, D. C. 20515

Dear Mr. Chairman:

We understand that your Committee will conduct a hearing on July 15, 1986, regarding the growing problem of evasion of federal motor fuel taxes.

The Policy Committee of AASHTO, which is comprised of the chief administrative officers of the departments of highways and transportation in the 50 states, the District of Columbia and Puerto Rico, discussed this matter during our recent June 30/July 1, 1986 meeting in Itasca, Illinois. At the conclusion of the discussion, the enclosed Policy Resolution PR-3-86 was adopted, titled "Elimination of Evasion of State and Federal Motor Fuel Excise Taxes". It calls upon the Congress and the Administration to examine the current system of federal motor fuel excise tax collections, and enact such changes as are needed to eliminate the evasion of the tax.

As is made clear by this resolution, we are supportive of any effort by your Committee to solve this problem. If there is any way in which we or our member departments can be of assistance, please let us know.

In closing, I would note that as stated in the resolution we also recognize this same problem may exist at the state level. Several of our member departments are now reviewing the matter.

Very truly yours,

Frank Francois

Francis B. Francois
Executive Director

FBF:mlm

EXECUTIVE OFFICE: 444 N. Capitol Street, N.W., Suite 225 Washington D.C. 20001 Telephone (202) 624-5800

AMERICAN ASSOCIATION OF STATE HIGHWAY
AND TRANSPORTATION OFFICIALS

THOMAS D. LARSON President
Secretary
Pennsylvania Department
of Transportation

FRANCIS B. FRANCOIS
Executive Director

Policy Resolution PR-3-86

Elimination of Evasion of State and Federal Motor Fuel Excise Taxes

WHEREAS, it is estimated that the systematic evasion of state and federal motor fuel excise taxes is resulting in the annual loss of more than $1 billion dollars in highway revenues, seriously eroding the ability of the federal and state governments to fund needed highway projects;

WHEREAS, the evasion of the federal motor fuel excise tax is currently under investigation through a cooperative effort by the U. S. Treasury Department, the Internal Revenue Service, the Justice Department, the Federal Bureau of Investigation and the Federal Highway Administration, with legislative recommendations expected to be forthcoming;

WHEREAS, experience has proven that returning the point of taxation to the refiner or importer level has substantially decreased motor fuel excise tax evasion in the state of New York; and

WHEREAS, the level of highway expenditures under the federal-aid highway program is dependent upon income to the Highway Trust Fund, and the elimination of evasion of the federal motor fuel excise tax may result in substantial increases to the Highway Trust Fund.

NOW THEREFORE, BE IT RESOLVED, that the Congress and the Administration should examine the current system of federal motor fuel excise tax collections and enact such changes as are needed to eliminate the evasion of the federal motor fuel excise tax;

BE IT FURTHER RESOLVED, that states be encouraged to examine their current systems of state motor fuel tax collections, to determine what steps might be taken to eliminate state motor fuel tax evasion.

As Approved by the Policy
Committee on June 30, 1986 by
more than the required
two-thirds majority vote of
all 52 member departments

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S. L. McDonald
Vice President
Distribution

RECEIVED
Ways and Means
Subcommittee on Oversight

July 21, 1986

The Honorable J. J. Pickle
Committee on Ways and Means
Subcommittee on Oversight
U. S. House of Representatives
1105 Longworth House Office Building
Washington, D.C. 20515

Dear Chairman Pickle:

We had the opportunity to meet with Bill Cunningham and Tom Meyerer, members of the Subcommittee on Oversight staff, on July 9, 1986, relative to the problem of evasion of petroleum taxes. I want to take this opportunity to summarize for you the views we made known to them.

Atlantic Richfield feels very strongly about this problem since the evasion of petroleum taxes by tax cheaters deprives governments of needed tax dollars and has a devastating effect upon those honest gasoline marketers who are trying to compete on the street. That includes us, but more importantly, the vast majority if not all of the independent distributors and retailers who are our customers.

Bootlegging, daisy chains and other illicit schemes must be eliminated. Our Company has been very supportive of efforts to achieve this objective. I was a member of Governor Cuomo's Joint Industry/Government Task Force on Petroleum Taxes. The recommendations of that group led to new laws being enacted in 1985 designed to reduce tax evasion in New York. We also strongly supported California Senate Bill 1610 which called for refiners to pre-collect 60 percent of the California Sales Tax. That Bill was also designed to both assure revenue as well as provide an audit trail to tax abusers; it was enacted into law effective July 1, 1986.

Atlantic Richfield would support legislation designed to curb tax evasion by mandating collection of the Federal Gasoline Excise Tax when the first sale is made at the refiner or importer level. Thus, the Federal Excise Tax would be collected at an earlier point in the distribution chain and would involve far fewer tax collectors.

ARCO Petroleum Products Company is a Division of AtlanticRichfieldCompany

Some distributor groups have complained that their members would lose a cash flow advantage occurring from their access to the "float" which results from their use of the Federal government's money from the time they collect it until the time it is remitted. We understand that a proposal has been set forth calling for a "dual invoicing" system which would protect the distributor's cash float if the incidence of tax collection is shifted to refiners. Under such a proposal, refiners would send a separate bill to distributors covering the Federal Tax owed a number of days after they purchased the product (for example, 14 days).

Atlantic Richfield opposes any "dual invoicing" proposal. Such a proposal would create an expense for refiners to establish an entirely new business system just for the purpose of providing some distributors with the use of government money on an interest-free basis.

State and federal taxes have been historically collected on invoices that document product sales transactions. This is beneficial for both the seller and the purchaser since the price charged for the product and the taxes collected are clearly identified on the invoice. Any questions or disputes relative to the accuracy of prices, taxes and the customer's account balance can be usually resolved by referring to invoice documentation.

Dual invoicing would require a new computer program so that separate charges could be made for Federal Excise Taxes owed on products previously sold. That system would generate additional statements providing such data as the date, invoice number and gallons previously sold.

A dual invoicing system would require additional time on the part of our personnel to administer our accounts receivable for distributors and to resolve disputes which arise relative to balances owed. In fact, we believe that many distributors may oppose such a system since it will be more difficult for them to reconcile their own accounts payable. Finally, there would also be occasions where refiners would pay the Federal Excise Tax to the government prior to receiving payment of the taxes from distributors.

If there is a desire on the part of legislators to minimize the impact of the loss of the float for distributors, we would recommend that the Federal government implement procedures similar to what California and New York utilized when they implemented their new tax laws. For example, to minimize the effect of any possible negative cash flow caused by the advance payment of sales tax to refiners, California gasoline retailers engaged in business on July 1, 1986, will be permitted to apply for a one-time credit against their tax liability due for the period ending June 30, 1986, in an amount of tax equal to the liability imposed at four cents per gallon of motor vehicle fuel sold by that retailer during the month in which the retailer sold the highest number of gallons during the 12-month period immediately preceding the effect date of the legislation. Any excess of credit over the amount of the tax liability due may be carried over to the next reporting period. The amount of credit allowed must be repaid to the State (without interest) in four equal quarterly installments beginning with the return due for the quarterly period ending October 31, 1986. If the retailer ceases to do business in California before the payments are all made, any balance due must be remitted to the State with the retailer's final sales and use tax return.

New York implemented a similar system for delayed payback of taxes due for entities who apply due to hardship. We believe the programs employed by these two states are a much more desirable alternative than the "dual invoicing" proposal.

We would be happy to meet with you and your staff at any time if you have questions or need additional information relative to this subject.

Sincerely,

S. L. McDonald

SLM:mlg

Ashland

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TAX DEPARTMENT

July 28, 1986

Mr. Joseph Dowley
Chief Counsel
Committee on Ways & Means
U. S. House of Representatives
Room 1102, Longworth HOB
Washington, DC 20515

RE: Federal Gasoline Excise Tax Evasion

Dear Mr. Dowley:

Ashland Oil, as a company that both remits federal gasoline excise taxes and sells to others on a tax-exempt basis, wishes to file written comments on the various proposals under review to reform the current system to reduce or eliminate evasion of federal taxes.

We are not convinced that $1 billion per year in gasoline tax payments are being avoided. As the Oversight Subcommittee found at the July 15 hearing, the estimates of the amount of federal tax evasion are based on minimal data. Nonetheless, we recognize that substantial amounts are involved and we strongly support greater enforcement efforts by federal and state officials to investigate and prosecute those who evade the payment of taxes. Until the recent publicity of the New York state tax case and the related Iorizzo case, there was not much basis for fear of prosecution for tax evasion. Given the complex "daisy-chains" constructed in the model case of Mr. Iorizzo, we have little reason to believe that the IRS and FBI could successfully build a case if they weren't certain from the beginning who controlled the "burn-out" company.

Since heating oil and diesel fuel are similar products and one is taxable and the other is not, we suspect that evasion of the diesel fuel tax is a much more significant problem than the gasoline tax problem. The diesel fuel issue should be addressed separately, however.

The Treasury Department suggested at the July 15 hearing that the method of collection of the federal gasoline excise tax be changed to imposing the tax at the point at which the gasoline is first removed from the refinery, or at the terminal for imported gasoline. Treasury maintains that going back to the pre-1959 system with the tax payment at "manufacture" rather than at sale to someone outside direct ownership, would eliminate much of the problem.

Ashland Oil does not object to the basic proposal to move the gasoline taxable event to the refiner or importer and to have jobbers and other marketers buy their gasoline on a tax-paid basis, provided that the incidence of the tax is at the point at which the product is removed from the refiners' marketing facilities and sold to his customer, except when that customer is another refiner. It is important to keep in mind, however, that whatever system is devised it should not cause jobbers and other marketers an undue hardship.

While, as we have indicated, Ashland Oil does not object to the basic proposal, we do want to refute some of the contentions PMAA has made. Jobbers contend that refiners enjoy a cash flow advantage under the accelerated deposit rules. That is not true. Refiners have nine days to collect and deposit tax at the end of semimonthly deposit periods. Assuming that all sales with the usual credit terms are invoiced on the day of delivery and the two-day mailing requirement for tax deposits is used, this consumes the nine-day deposit rule. For example, the average age of our refinery sales accounts receivable is approximately 15½ days. This means that tax collected during the first fifteen days (first deposit period) of a month is not available for deposit until about the twenty-second day of a month. Add the two-day mailing time, and the total time equals the total time allowed for deposits. The average age of receivables would be extended for companies with credit card sales. Additional time given to jobbers to delay tax payments would create added expense and cash flow problems for refiners.

We do not believe that bulk sales by jobbers to tax-exempt political subdivisions are a major problem. Ashland's sales to exempt customers represent less than 1% of our total gasoline sales. If, however, Treasury found it easier to eliminate all exemptions from payment, certainly a tax credit or refund system could be implemented for all tax-exempt users similar to the one currently in place.

The ethanol blend credit advantage does not exist. The 60¢ alcohol credit is passed along in the form of a tax rate reduction, nine cents to three cents. A separate credit does not occur.

An allowance for shrinkage, evaporation and temperature compensation for jobbers is not warranted. Jobbers have an option to be invoiced on either gross gallons or temperature corrected gallons. Temperature adjusted gallons mean that volume metered gallons are adjusted to a mean temperature of 60°F. As a result, jobbers in areas where the average temperature is more than 60°F generally opt to be invoiced on temperature adjusted gallons, while those jobbers in areas where the average temperature tends to be less than 60°F generally elect to be invoiced on a gross gallonage basis. These options tend to eliminate any temperature compensation losses.

While we do not believe that refiners in general are opposed to collecting federal tax on all gasoline sales, preparing separate invoices for tax on sales to jobbers would be unmanageable and it would not be justified. Prior to January 1, 1960, refiners collected tax from jobbers. The proposal by jobbers that they not pay refiners the tax until it is actually due would adversely effect our cash flow, credit and invoicing procedures.

Ashland Oil does not believe that severe bonding requirements for licensed dealers will relieve the problem of fraud. Bonding requirements do little but penalize the already honest taxpayer. In the final analysis, we believe that nothing is more effective, in the proper administration of any tax law, than vigorous enforcement.

In conclusion, Ashland would not object to moving the taxable event back to the point of first sale, to other than another refiner, from refiners' marketing facilities. However, we urge Treasury to consult with oil industry tax experts to create a system which unduly burdens neither refiners nor marketers. We volunteer to participate in such a process with the federal agencies and with Congress to work out an agreement so that effective legislation can be put in place on a timely basis.

Sincerely,

John McD. Ross
Director, Tax Compliance

EXXON COMPANY, U.S.A.
POST OFFICE BOX 2180 • HOUSTON, TEXAS 77252-2180

MARKETING DEPARTMENT

R. P. LARKINS
VICE PRESIDENT

July 24, 1986

The Honorable J. J. Pickle, Chairman
Subcommittee on Oversight
Committee on Ways and Means
U.S. House of Representatives
1101 Longworth House Office Building
Washington, D.C.

Dear Chairman Pickle:

Exxon Company, U.S.A. submits the following comments for the record of the July 15, 1986 hearing to examine compliance with the federal gasoline excise tax laws and related federal enforcement efforts.

Exxon believes that some federal gasoline excise tax evasion is occurring, but does not know the extent of it. Any level of motor fuel tax evasion is of concern to Exxon because persons or firms retailing gasoline on which taxes have not been paid have an unfair and significant competitive advantage in the marketplace. Gasoline retailers in direct competition with tax cheaters will likely experience a loss of sales volume or a loss of margin to maintain volume. In either case, their operating profit is adversely affected because income of the retail gasoline business is very sensitive to changes in volume or margin. Since Exxon sells a large portion of its gasoline through independent retail dealer operations, it is concerned about the economic viability of its dealers whenever a market is disrupted by illegal activity.

Because of this concern, Exxon supports reasonable measures at the federal and state levels to eliminate or at least reduce the incidence of gasoline tax evasion. Such measures include the stepped-up enforcement of existing laws and increased penalties for those convicted of tax evasion. In addition, Exxon supports improved collection methods--specifically, the concept of collecting the federal gasoline excise tax on its first sale by a refiner or importer. The reduction in the number of tax collectors implicit in this approach would improve controls and lower administrative costs to the federal government. It also would help avoid the "daisy chain" scam of clouding an audit trail, which can facilitate tax evasion.

Exxon is aware that many registered producers, who now are permitted to collect the federal excise tax, wish to continue this practice in order to preserve the related financial float advantage. This is an understandable concern. Congress should address the float issue by adopting a procedure similar to that used in some states that have changed their tax laws to collect gasoline taxes upon the first sale. Such a procedure allows for the deferral of the payment of taxes due from former collector distributors, and provides a transitional solution that can handle the cash float problem equitably on a one-time basis. Some hearing witnesses suggested that refiners support the concept of fewer tax collectors because they will enjoy a greater float advantage. This argument has little merit since refiners are required to pay the federal excise tax twice a month, and the 1985 industry average days receivable for distributor customers was essentially the same as the refiners' float period.

In conclusion, if Congress decides that legislation is needed to mitigate the motor fuel tax evasion problem, the proposal should strive for simplicity and equity, and should avoid solutions that would complicate the administration and collection of the motor fuel excise tax.

Sincerely,

RPL:kc

c: Members, Ways and Means Oversight Subcommittee

MORTON THIOKOL, INC.
Morton Chemical Division
James J. Fuerholzer
Vice President
Petroleum and Industrial Dyes

October 9, 1986

Representative J. J. Pickle
Chairman, Subcommittee on Oversight
Committee on Ways and Means
House of Representatives
Washington, D.C. 20515

Dear Representative Pickle:

On October 1, John Haddow and I met with Ms. Rusty Guritz and Mr. Thomas Meyerrof your subcommittee to discuss the hearing which had been held on the evasion of gasoline excise tax.

Morton Chemical Division has long been involved in working with governments worldwide to supply marker systems which can be used to identify fuel products for the purpose of preventing tax evasion. Additionally, our markers are used to identify fuels to prevent consumer fraud resulting from adulteration of one fuel with another.

I have attached a brief report on markers and how they can be used in both tax evasion and adulteration problems.

We request that this report be added to record on the hearing held on evasion of gasoline excise tax.

We stand ready to share our expertise and the experience we have gained in using markers to prevent problems such as tax evasion and fuel adulteration.

Very truly yours,

MORTON CHEMICAL

James J Fuerholzer

JJF/dac

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Report to the Subcommittee on Oversight, Committee on Ways and Means

Use of Chemical Markers to Control Tax Evasion on Petroleum Fuels

Morton Thiokol, Inc., Morton Chemical Division is engaged in the manufacture of a variety of specialty chemicals. Among the products manufactured are markers or tracers for use in petroleum products.

These products are used around the world to deter fuel tax evasion as well as to control adulteration of one fuel with another.

Fuel Tax Evasion

Fuel tax evasion is a problem in many parts of the world.

Heating oil as well as diesel fuel used for agricultrual or marine use is normally not taxed or taxed at a rate substantially lower than diesel fuel used for over the road use.

Heating oil can be used in diesel engines even though it does not contain additives such as cetane boosters and the like. Thus, a way to avoid tax is to purchase oil declared for use in heating and use it for over the road use or use it to dilute down diesel fuel purchased and taxed for over the road use.

The traditional mechanism to control misuse of untaxed fuel oil has been through licensing and auditing. However, large amounts of untaxed fuel oil are handled by large numbers of people on almost a daily basis. Control becomes difficult and involves large numbers of auditors, accountants and investigators as well as a clear "paper trial." For the most part, this mechanism has not been too successful.

An alternative to the traditional approach of controlling the misuse of untaxed fuels has been used successfully in countries around the world.

The approach, first used in Canada in 1939, involves the addition of small amounts of special chemical markers to the untaxed fuel so it can be easily and quickly identified from taxed fuels either neat or when used to dilute taxed fuels.

This approach is now used in Canada and throughout Europe.

Adulteration of One Fuel with Another

In many countries of the world, great financial gain can be realized by adulterating a more expensive fuel with a less costly one and then selling the adulterated product at the price of the expensive fuel.

In many parts of the world, it is common to find premium gasoline adulterated with lower octane gasoline, kerosene or diesel oil.

In the Philippines, the government subsidizes the cost of kerosene and it is sold at very low prices. Prior to instituting a marking program, it was common practice to adulterate gasoline with kerosene. The marking program started about two years ago has corrected this problem.

Recent reports in the U.S. have indicated adulteration of unleaded gasoline with leaded gasoline as well as gasoline adulterated with methanol.

We think chemical markers can be used to deter excise tax evasion on gasoline as well as other fuels in the United States.

Such a program in its simplest form involves two separate actions; addition of the marker and enforcement.

The cost of the marker would add only a fraction of a cent per gallon to the fuel. Depending on the marker used, this cost would be in the range of $0.00037 to $0.0006 per gallon of fuel marked.

The markers are liquids which could be added to the fuel via metering pumps or injectors commonly used in the petroleum industry.

We believe a marking program is feasible in the United States and could deter tax evasion.

Addition of the marker could be done at the loading rack. Enforcement could be carried out by state agencies such as weigh stations. The states have a vested interest in overcoming the evasion problem. If federal taxes are being evaded, it is almost certain that the state tax is being evaded.

Morton Chemical
October 9, 1986

NATIONAL PETROLEUM REFINERS ASSOCIATION

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URVAN RUIZ STERNFELS
PRESIDENT

RECEIVED
AUG 28 1986
Ways and Means
Subcommittee on Oversight

August 22, 1986

The Honorable J. J. Pickle
Joint Committee on Taxation
United States House of Representatives
Washington, D.C. 20515

AUG 26 1986

Dear Congressman Pickle:

The National Petroleum Refiners Association supports the concept of eliminating federal gasoline tax evasion by placing the legal incidence of tax on terminal disbursements.

As a major trade association whose membership includes large and small petroleum refiners and marketers, NPRA agrees that evasion of the federal excise tax on gasoline is a matter of serious concern. In addition to the losses of tax revenue, cheating creates very real competitive disadvantages for reputable gasoline marketers.

The best way to eliminate excise tax evasion is to significantly reduce the number of entities licensed to collect and remit the federal excise tax without imposing unnecessary administrative or competitive burdens on any segment of the gasoline distribution system.

Any new collection procedure adopted should allow bulk shipments of gasoline to be sold or exchanged on a tax-free basis, so as to not create a financial hardship on refiners who move large quantities through what is a sometimes lengthy distribution system. To impose the tax at the refinery gate would create an immediate and serious cash flow problem for refiners, many of whom are already burdened with severe financial constraints. At the same time, of course, no gasoline should be allowed to enter the retail market tax-free. By imposing the excise tax on the first transaction where the product "breaks bulk," the number of entities collecting the tax would be limited to those relatively few entities who purchase, sell, or exchange product in pipeline batches or cargo lot quantities. This would provide a clear accounting for gasoline sales and taxes, and greatly reduce enforcement time and effort.

We believe that by eliminating exemptions for wholesale distributors and chain operators, and placing the legal incidence of tax on terminal disbursements, federal revenue collection would be enhanced by about $1 billion over five years. This action would also promote equity within all segments of the gasoline marketing industry.

Sincerely,

Urvan R. Sternfels

STATEMENT OF

ROBERT ABRAMS
ATTORNEY GENERAL
STATE OF NEW YORK

Mr. Chairman, members of the Subcommittee, I am pleased to have this opportunity to present to the Subcommittee my views regarding gasoline tax evasion. It has been estimated that as much as Two hundred million dollars per year is evaded in local, state and federal taxes on sales of fuel in New York State alone. Accordingly, my office has placed a high priority on investigating and prosecuting cases in this area.

Over the past decade, organized crime has been undergoing a reevaluation of sorts. Its method of operation hasn't changed and it still maintains its corrupt foundation in such core industries as gambling, narcotics and prostitution. Nonetheless, like many legitimate conglomerates, it has begun to diversify into other businesses as a hedge. In the case of organized crime, it is a hedge against the continued successes of law enforcement in attacking its traditional rackets.

As the American economy moves from smoke stack industries and becomes more service oriented so too does the economy of organized crime. My office has seen, and is battling, attempts by organized crime to control the wholesale and retail distribution of gasoline.

There is no simple way that organized crime moves in to take over a business, or an industry...and the takeover of an industry can start with a single business. These takeovers, however, often follow a similar pattern.

They often begin with "legitimate" businessmen cutting corners, following their own rules and disregarding those laws that they disagree with or think were intended for someone else.

Once a usurious loan is accepted, or a territory is illegally carved up to thwart competition, or bootleg gasoline is purchased with the taxes washed off, who does the so-called legitimate businessman complain to when the lords of organized crime come and demand their tribute?

Those individuals, having cut those corners, often find themselves cut off from complaining to law enforcement agencies, either compromised by their own conduct or coerced into silence.

We should never lose sight of the fact that the ultimate weapons of organized crime are fear and violence. The people behind organized crime are not the romantic figures of movie lore. They are common thugs. Their efforts to expand into legitimate business should not be misinterpreted as the renunciation of their prior methods. Rather, we should recognize that they intend to use their tried and true methods in these new enterprises.

My office has been in the forefront of a combined federal, state and local law enforcement effort, seeking to blunt an attempt by organized crime to take control of the wholesale and retail distribution of gasoline. Every gallon of gasoline sold in New York State has a minimum of twenty-one cents in federal, state and local taxes included in its price and in some areas of the state, those taxes rise to twenty-seven cents or more. In an industry where high volume and low mark-up were long the rule it is not difficult to imagine what can happen if someone can deliver tax free gasoline to the market.

So-called legitimate businessmen started out with small scale tax evasion by receiving small accommodations from organized crime. It did not take long, however, before organized crime supplanted those no longer legitimate businessmen, taking control of both their businesses and their lives. With profits from this tax evasion running into the hundreds of millions of dollars and rivaling that of the narcotics trade, it is not surprising that organized crime moved in. Phony companies were established, territories allocated, prices set, dissidents dealt with, and, most importantly, profits divided.

Mr. Chairman, what should be clear from the experience of the State of New York is that stopping gasoline tax evasion is not just a means of increasing revenue, it is a major step in combatting organized crime infiltration of legitimate industry. Our investigation has demonstrated the spread of this problem well beyond the borders of New York. Our experience further tells us that organized crime, as well, learns from its experience. It would, I submit, be naive not to expect attempts to duplicate this type of evasion in parts of the country where it has yet surfaced.

In combatting this problem we have learned that cooperation between law enforcement agencies is essential. Several years ago investigators from my office and the FBI were literally following the same people at the same time. These incidents played a significant role in the task force approach that was adopted in November of 1982. Under the auspices of the United States Attorney for the Eastern District of New York a task force was formed which we informerly call the Long Island Oil Industry Organized Crime Task Force. It now consists of my office, the District Attorneys of Nassau and Suffolk County, the Eastern District Organized Crime Strike Force, the Attorney General of the State of New Jersey, the New York State Department of Taxation and Finance, the Federal Bureau of Investigation, the Internal Revenue Service and the Nassau and Suffolk County Police Departments.

The battle of the task force against gasoline tax evasion in New York is far from being over. I believe, however, that we have reached the turning point in this particular skirmish against organized crime and that the tide has now turned in our favor. The indictments and convictions thus far obtained, and indictments I expect to announce in the near future, have and will play a role in taking the profit out of this form of tax evasion.

This problem can not be dealt with by enforcement actions alone. I believe, however, that the specifics of any changes in the Internal Revenue Code should be left to those more familiar with the problems presented by the day to day implementation of any such changes. I do suggest though, that the SubCommittee examine the following areas:

1) Transfer of the point of excise tax collection to the refinery or importation level.

2) Strengthening the requirements for the obtaining of Federal Excise Tax Exemption numbers (commonly known as "637's").

3) Require bonds for those holding a "637" number.

Mr. Chairman, members of the Sub-Committee that concludes my prepared statement. If you have any questions, Assistant Attorney General John Michael Ryan, the Chief of my Criminal Prosecutions Bureau would be happy to respond to them.

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